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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1938

No. 65

DOUGLAS FAIRBANKS, PETITIONER,

vs.

THE UNITED STATES OF AMERICA

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE NINTH CIRCUIT**

PETITION FOR CERTIORARI FILED MAY 23, 1938.

CERTIORARI GRANTED JANUARY 16, 1939.

SUPREME COURT OF THE UNITED STATES

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For Appellee and Cross-Appellant:

PEIRSON M. HALL, Esq.,

United States Attorney,

ALVA G. BAIRD, Esq.,

Assistant United States Attorney,

EUGENE HARPOLE, Esq.,

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Los Angeles, California.

United States of America, ss.

TO UNITED STATES OF AMERICA, PEIRSON M. HALL, ESQ., United States Attorney, E. H. MITCHELL, ESQ., Special Assistant United States Attorney, and to ALVA C. BAIRD, Assistant United States Attorney, Attorneys for said United States of America, Greeting:

You are hereby cited and admonished to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be held at the City of San Francisco, in the State of California, on the 31st day of December, A. D. 1936, pursuant to Order allowing Appeal, filed December 2, 1936, in the Clerk's Office of the District Court of the United States, in and for the Southern District of California, in that certain case entitled United States of America v. Douglas Fairbanks, Docket No. 6680-J, wherein United States of America is plaintiff and respondent and Douglas Fairbanks is defendant and appellant, and you are ordered to show cause, if any there be, why the Judgment rendered against the defendant and appellant on October 5, 1936, in the said action mentioned, should not be corrected, and speedy justice should not be done to the parties in that behalf.

WITNFSS, the Honorable WILLIAM P. JAMES United States District Judge for the Southern District of California, this 2nd day of December, A. D. 1936, and of the Independence of the United States the one hundred and sixtieth.

Wm. P. James

U. S. District Judge for the Southern District
of California.

Due service of within Citation by receipt of true copy is hereby acknowledged this 2nd day of December, A. D. 1936.

Peirson M. Hall

Peirson M. Hall,

United States Atty.

E. H. Mitchell

E. H. Mitchell,

Special Asst. United States Attorney.

Alva C. Baird

Alva C. Baird,

Asst. United States Attorney.

Attorneys for United States of America.

[Endorsed]: Filed Dec. 3, 1936. R. S. Zimmerman,
Clerk. By L. B. Figg, Deputy Clerk.

United States of America, ss.

To Douglas Fairbanks and to Claude I. Parker & Ralph W. Smith, his attorneys: Greeting:

You are hereby cited and admonished to be and appear at a United States Circuit Court of Appeals for the Ninth Circuit, to be held at the City of San Francisco, in the State of California, on the 28 day of January, A. D. 1937, pursuant to petition for cross-appeal and order allowing the same filed Dec. 29, 1936, in the Clerk's Office of the District Court of the United States, in and for the Southern District of California, in that certain action entitled United States vs. Douglas Fairbanks, No. 6680-J, wherein United States is plaintiff and cross-appellant and you are defendant and cross-appellee to show cause, if any there be, why the Judgment in the said cause mentioned, should not be corrected, and speedy justice should not be done to the parties in that behalf.

WITNESS, the Honorable WM. P. JAMES United States District Judge for the Southern District of California, this 29 day of December, A. D. 1936, and of the Independence of the United States, the one hundred and sixty-first

Wm. P. James

U. S. District Judge for the Southern District
District of California.

[Endorsed]: Service of a copy of the above citation, together with a copy of petition for cross-appeal, order allowing cross-appeal, and plaintiff's and cross-appellant's assignment of errors is hereby acknowledged this 29 day of December, 1936. Claude I. Parker By John B. Milliken Attorneys for Defendant and Cross-Appellee. Filed Dec 29 1936 R. S. Zimmerman, Clerk By Edmund L. Smith Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED
STATES IN AND FOR THE SOUTHERN
DISTRICT OF CALIFORNIA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)	
)	6680 J
Plaintiff,)	
)	COMPLAINT
vs.)	
)	For Recovery of
DOUGLAS FAIRBANKS,)	Taxes
)	Erroneously
Defendant)	Refunded.

Plaintiff, United States of America, by Peirson M. Hall, United States Attorney, in and for the Southern District of California, Central Division, Alva C. Baird, Assistant United States Attorney in and for said District, and Eugene Harpole, Special Attorney, Bureau of Internal Revenue, sues the defendant, Douglas Fairbanks, in this, its first cause of Action, for money had and received in the sum of One Hundred Fifty-four Thousand, One Hundred Eighty-seven and Twenty-four One Hundredths (\$154,187.24) Dollars, with Interest thereon as provided by Law, until paid, and for the costs of this action, says for its first cause of action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood

in the County of Los Angeles, State of California, within the jurisdiction of this Court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved February 26, 1926 (44 Stat. 9.) which is hereinafter referred to as the Revenue Act of 1926, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, the defendant, Douglas Fairbanks, on or about March 14, 1928 filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1927, upon Form 1040, commonly known as an Individual Income Tax Return.

V.

That in his said income tax return for the calendar year 1927, the defendant, Douglas Fairbanks, reported a net income of \$50,817.31, and a capital net gain of \$1,600,000.00 received from the Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year 1927, from

which defendant took no deduction for cost, and which was returned for taxation at the capital gain rate of $12\frac{1}{2}\%$, for said year 1927, and said return disclosed a tax due thereon in the amount of \$205,113.99 which was duly assessed by the United States Commissioner of Internal Revenue on his 1928 Serial or Account Number 304130 Assessment List and was paid by the defendant in quarterly installments of \$51,278.50 each on March 12, 1928, June 14, 1928, September 13, 1928 and December 14, 1928.

VI.

That thereafter and on or about August 29, 1930, the defendant, Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue, a claim and application for the refund of \$53,231.55 of the sum paid by him as Income Taxes for the taxable year 1927 and in said claim alleged as a ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts & Disbursements basis and Income Tax returns filed accordingly.

"At conferences with a Special Conference Committee held during March - 1929 in Washington, D. C., it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year and 5% the fourth year.

"On March 5th, 1925, I exchanged my interests in various completed motion pictures and other assets for \$4,000,000.00 par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of The Elton Corporation. The value of the pictures

and other assets exchanged was established in my agreement with the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7th, 1930, at \$1,096,445.52.

"On April 5th, 1927, and subsequently thereto, during the year 1927, The Elton Corporation called and paid me for \$1,600,000.00 par value debenture bonds. Inasmuch as my income tax returns have been filed on a Cash Receipts & Disbursements basis and consequently the entire cost of pictures deducted from my income within the years expended, I treated the entire \$1,600,000.00 as capital net gain and so reported same on my 1927 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927, as stated above, and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$1,600,000.00 is to \$4,000,000.00 as cost of said bonds redeemed. Since \$1,600,000.00 is 40% of \$4,000,000.00 and 40% of \$1,096,445.52 is \$438,578.21, there remains \$1,161,421.79 capital net gain instead of \$1,600,000.00 as originally reported.

"The tax on this capital net gain is to be offset by the disallowance of deductions claimed against ordinary income in the amount of \$8,271.97 as reflected in Revenue Agent, L. E. Fellers report dated August 7, 1930, leaving a net overpayment of \$53,231.55.

"Refund of interest on the overpayment is also claimed under provision section #614, Revenue Act of 1928."

VII.

That thereafter an audit was made of the defendant's said 1927 return, in connection with said claim for refund, under the direction of the Commissioner of Internal Revenue. As a result thereof, the Commissioner of Internal Revenue determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1927 in the amount of \$438,578.21, being the proportionable amount of cost attributable to the capital gain so reported, with a corresponding reduction in his capital gain tax returned and a reduction in his total tax liability.

VII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 2155767 was duly scheduled by the Commissioner of Internal Revenue on overassessment schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in defendant's 1927 return in the amount of \$53,231.55 as tax and \$9,795.05 as interest, which said amounts were duly determined to be refundable as an overpayment of defendant's 1927 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from the Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year 1927 constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr. v. Commissioner, 27 B. T. A. 463, and not capital gain; but that the gross income of \$1,600,000.00 received from said source should be reduced by the sum of \$438,578.21, rep-

resenting the proportionate cost of the particular bonds redeemed by the said Elton Corporation during the year 1927. The result of said redetermination of defendant's tax liability for the year 1927 discloses a deficiency in the tax reported upon his return in the amount of \$91,160.64 instead of an overpayment of tax in the sum of \$53,231.55 as previously determined by the Commissioner of Internal Revenue.

X.

That said claim for refund of \$53,231.55 of the sum paid by the defendant, Douglas Fairbanks, as a tax upon his reported net income and capital gains for the calendar year 1927 was through mistake and error as to the applicable taxing statute mistakenly and erroneously allowed by the United States Commissioner of Internal Revenue, and said amount of \$53,231.55 of said 1927 taxes, together with interest thereon in the sum of \$9,795.05 were, on January 26, 1932, duly refunded to the defendant by delivery to him of the check of the disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$1,600,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1927. That by reason of said mistake the said Commissioner of Internal Revenue failed to assess an additional tax against the defendant in the sum of \$91,160.64 for the taxable year 1927, although said additional tax was, and now is justly due, owing and wholly unpaid from said defendant to the plaintiff.

XII.

That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in allowing defendant's claim for refund of a portion of his 1927 taxes as set forth above, the said sum of \$53,231.55 and interest thereon in the amount of \$9,795.05 were mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1927 when the refund was made.

XIII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928 (45 Stat. 791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon. That under said Section of the Revenue Act, Plaintiff is further entitled to recover an additional amount of \$91,160.64, together with interest thereon from the 15th day of March, 1928, from defendant.

XIV.

That defendant, though liable to repay said sum of \$53,231.55 with interest thereon in the amount of \$9,795.05, and to pay the additional amount of \$91,160.64 with interest thereon, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sums, or any part thereof to the plaintiff. That none of said sums or any part thereof have been repaid or paid to the plaintiff by the

defendant, or by any person or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$53,231.55, with interest thereon in the amount of \$9,795.05, on account of the refund so made on or about the 26th day of January, 1932, and the further sum of \$91,160.64 as an additional amount due but unreported on his said income tax return filed for the calendar year 1927.

SECOND CAUSE OF ACTION

Plaintiff sues the defendant in this, its second cause of action, for money had and received in the sum of \$13,697.21 with interest thereon as provided by law until paid and says for its second cause of action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood in the County of Los Angeles, State of California, within the jurisdiction of this Court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved May 29, 1928 (45 Stat. 791-875.), which is hereinafter referred to as the Revenue Act of 1928, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, the defendant, Douglas Fairbanks, on or about March 12, 1929 filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1928, upon Form 1040, commonly known as an Individual Income Tax Return. Defendant filed an Amended Individual Income Tax Return upon Form 1040 on July 12, 1929, for said Calendar Year.

V.

That in his said income tax returns for the calendar year 1928 the defendant, Douglas Fairbanks, reported a net income of \$69,024.72, a capital net gain of \$150,000.00 received from the Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year of 1928, from which defendant took no deduction for cost, and which was returned for taxation at the capital gain rate of 12- $\frac{1}{2}$ %, for said year 1928, and said Original income tax return disclosed a tax due thereon in the amount of \$28,878.66 which was duly assessed by the United States Commissioner of Internal Revenue on his 1929 Assessment List, Serial or Account Number 303283 and was paid by the defendant in quarterly installments of \$7,219.67 or \$7,219.66 each on March 12, 1929, June 14, 1929, September 13, 1929 and December 14, 1929.

VI.

That thereafter and on or about August 29, 1930, the defendant, Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue a claim and application for the refund of \$7,507.38 of the sum paid by him as income taxes for the taxable year 1928 and in said claim alleged as a ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts & Disbursements basis and Income Tax returns filed accordingly.

"At conferences with a Special Conference Committee held during March - 1929 in Washington, D. C., it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year and 5% the fourth year.

"On March 5th, 1925, I exchanged my interests in various completed motion pictures and other assets for \$4,000,000.00 par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of The Elton Corporation. The value of the pictures and assets exchanged was established in my agreement with the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7, 1930, at \$1,096,445.52.

"During the year 1928, the Elton Corporation called and paid me for \$150,000.00 par value debenture bonds. Inasmuch as my income tax returns have been filed on a Cash Receipts & Disbursements basis and consequently the entire cost of pictures deducted from my income

within the years expended, I treated the entire \$150,000.00 as capital net gain and so reported same on my 1928 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927 and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$150,000.00 is to \$4,000,000.00 as cost of said bonds redeemed. Since \$150,000.00 is 3.75% of \$4,000,000.00 and 3.75% of \$1,096,445.52 is \$41,116.71, there remains \$108,883.29 capital net gain instead of \$150,000.00 as originally reported.

"In addition to this decrease in capital net gain, additional deductions are claimed against ordinary net income in the net amount of \$11,136.55 as reflected in Revenue Agent L. E. Fellers report dated August 7, 1930, of this amount \$10,747.49 is deduction from ordinary net income as reflected in my amended return. This leaves a net overpayment for 1928 of \$7,507.38.

"Refund of interest on the overpayment is also claimed under provision section #614, Revenue Act of 1928."

VII.

That thereafter an audit was made of the defendant's said 1928 returns, in connection with said claim for refund, under the direction of the Commissioner of Internal Revenue. As a result thereof, the Commissioner of Internal Revenue determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1928 in the amount of \$41,116.71, being the proportionable amount of cost attributable to the capital gain so

reported, with a corresponding reduction in his capital gain tax returned and a reduction in his total tax liability.

VIII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 2,155,721 was duly scheduled by the Commissioner of Internal Revenue on overassessment schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in defendant's 1928 return in the amount of \$7,507.38 as tax and \$932.40 as interest, which said amounts were duly determined to be refundable as an overpayment of defendant's 1928 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from the Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year 1928 constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr. v. Commissioner, 27 B. T. A. 463, and not capital gain, but that the gross income of \$150,000.00 received from said source should be reduced by the sum of \$41,116.71, representing the proportionate cost of the particular bonds redeemed by the said Elton Corporation during the year 1928. The result of said redetermination of defendant's tax liability for the year 1928 discloses a deficiency in the tax reported upon his return in the amount of \$5,257.43 instead of an overpayment of tax in the sum of \$7,507.38 as previously determined by the Commissioner of Internal Revenue.

X.

That said claim for refund of \$7,507.38 of the sum paid by the defendant, Douglas Fairbanks, as a tax upon his

reported net income and capital gains for the calendar year 1928 was through mistake and error as to the applicable taxing statute mistakenly and erroneously allowed by the United States Commissioner of Internal Revenue, and said amount of \$7,507.38 of said 1928 taxes, together with interest thereon in the sum of \$932.40 were, on January 26, 1932, duly refunded to the defendant by delivery to him of the check of the disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$150,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1928. That by reason of said mistake the said Commissioner of Internal Revenue failed to assess an additional tax against the defendant in the sum of \$5,257.43 for the taxable year 1928, although said additional tax was, and now is justly due, owing and wholly unpaid from said defendant to the plaintiff.

XII.

That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in allowing defendant's claim for refund of a portion of his 1928 taxes as set forth above, the said sum of \$7,507.38 and interest thereon in the amount of \$932.40 were mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1928 when the refund was made.

XIII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928, (45 Stat. 791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon. That under said Section of the Revenue Act, Plaintiff is further entitled to recover an additional amount of \$5,257.43, together with interest thereon from the 15th day of March, 1929, from defendant.

XIV.

That defendant, though liable to repay said sum of \$7,507.38 with interest thereon in the amount of \$932.40, and to pay the additional amount of \$5,257.43 with interest thereon, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sums, or any part thereof to the plaintiff. That none of said sums or any part thereof have been repaid or paid to the plaintiff by the defendant, or by any person or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$7,507.38, with interest thereon in the amount of \$932.40, on account of the refund so made on or about the 26th day of January, 1932, and the further sum of \$5,257.43 as an additional amount due but unreported on his said income tax return filed for the calendar year 1928.

THIRD CAUSE OF ACTION

Plaintiff sues the defendant in this, its Third Cause of Action, for money had and received in the sum of \$8,042.66 with interest thereon as provided by law until paid and says for its Third Cause of Action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood in the County of Los Angeles, State of California, within the jurisdiction of this Court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved May 29, 1928 (45 Stat. 791-875), which is hereinafter referred to as the Revenue Act of 1928, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of

the Treasury, the defendant, Douglas Fairbanks, on or about March 14, 1930, filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1929, upon Form 1040, commonly known as an Individual Income Tax Return.

V.

That in his said income tax return for the calendar year 1929 the defendant, Douglas Fairbanks, reported a net income of \$26,204.28, a capital net gain of \$150,000.00 received from the Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year 1929, from which he took a deduction for cost in the amount of \$34,823.65, that being the proportionate amount of cost attributable to the capital gain received, and reported the balance of \$115,176.35 for taxation at the capital gain rate of 12½%, for said year 1929, and said income tax return disclosed a tax due thereon in the amount of \$54,135.85 which was duly assessed for the United States Commissioner of Internal Revenue on his 1930 Assessment List, Serial or Account Number 302363 and was paid by the defendant in quarterly installments of \$13,533.97 on March 1, 1930, June 14, 1930, September 15, 1930 and December 15, 1930.

VI.

That thereafter and on or about August 2, 1930, the defendant, Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue a claim for refund which was not accepted as such, but as additional information to be attached to defendant's income tax return for the calendar year 1928.

VII.

That thereafter an audit was made of the defendant's said 1929 return under the direction of the Commissioner of Internal Revenue. As a result thereof the Commissioner of Internal Revenue determined that the defendant was *entitled* a refund for the calendar year 1929.

VIII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 1256718, was duly scheduled by the Commissioner of Internal Revenue on Overassessment Schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in the amount of \$677.57 as tax and \$42.99 as interest, which said amounts were duly determined to be refundable as an overpayment of defendant's 1929 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from the Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year 1929, constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr. v. Commissioner, 27 B. T. A. 463, and not capital gain. The result of said redetermination of defendant's tax liability for the year 1929 discloses a deficiency in the tax reported upon his return in the amount of \$7,322.10 instead of an overpayment of tax in the sum of \$677.57 as previously determined by the Commissioner of Internal Revenue.

X.

That through mistake and error as to the applicable taxing statute, the United States Commissioner of Internal Revenue mistakenly and erroneously allowed the said

amount of \$677.57 of said 1929 taxes, together with interest thereon in the sum of \$42.99 as an overassessment of defendant's tax for the taxable year 1929 and said sums were on January 26, 1932, duly refunded to the defendant by delivery to him of the check of the disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$150,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1929. That by reason of said mistake the said Commissioner of Internal Revenue failed to assess an additional tax against the defendant in the sum of \$7,322.10 for the taxable year 1929, although said additional tax was, and now is justly due, owing and wholly unpaid from said defendant to the plaintiff.

XII.

That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in refunding a portion of the defendant's 1929 tax, as set forth above, the said sum of \$677.57 and interest thereon in the amount of \$42.99, was mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1929 when the refund was made.

XIII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928 (45 Stat.

791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon. That under said Section of the Revenue Act, Plaintiff is further entitled to recover an additional amount of \$7,322.10, together with interest thereon from the 15th day of March, 1930, from defendant.

XIV.

That defendant, though liable to repay said sum of \$677.57 with interest thereon in the amount of \$42.99, and to pay the additional amount of \$7,322.10, with interest thereon, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sums, or any part thereof to the plaintiff. That none of said sums or any part thereof have been repaid or paid to the plaintiff by the defendant, or by any person or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$677.57, with interest thereon in the amount of \$42.99, on account of the refund so made on or about the 26th day of January, 1932, and the further sum of \$7,322.10 as an additional amount due but unreported on his said income tax return filed for the calendar year 1927.

WHEREFORE, Plaintiff prays judgment against the defendant as follows:

1. For the sum of \$63,026.60 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;

2. For the sum of \$91,160.64 with interest thereon from the 15th day of March, 1928, to date of judgment at the rate of six per cent (6%) per annum;

3. For the sum of \$8,439.78 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;

4. For the sum of \$5,257.43 with interest thereon from the 15th day of March, 1929 to date of judgment at the rate of six per cent (6%) per annum;

5. For the sum of \$720.56 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;

6. For the sum of \$7,322.10 with interest thereon from the 15th day of March, 1930 to date of judgment at the rate of six per cent (6%) per annum;

7. For plaintiff's costs and disbursements in this action expended.

Peirson M. Hall

PEIRSON M. HALL

United States Attorney,

Alva G. Baird

E. H.

ALVA G. BAIRD

Assistant U. S. Attorney

Eugene Harpole

EUGENE HARPOLE,

Special Attorney,

Special Attorney,

Bureau of Internal Revenue,

Attorneys for Plaintiff.

[Endorsed]: Filed Jan. 20, 1934. R. S. Zimmerman,
Clerk. By Edmund L. Smith, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

AMENDED COMPLAINT.

Plaintiff, United States of America, by Peirson M. Hall, United States Attorney, in and for the Southern District of California, Central Division, Alva C. Baird, Assistant United States Attorney in and for said District, and Eugene Harpole, Special Attorney, Bureau of Internal Revenue, sues the defendant, Douglas Fairbanks, in this, its first Cause of Action, for money had and received in the Sum of Sixty-three thousand twenty-six and 60/100 (\$63,026.60) Dollars, with interest thereon as provided by Law, until paid, and for the costs of this action, says for its First Cause of Action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood in the County of Los Angeles, State of California, within the jurisdiction of this Court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved February 26, 1926, (44 Stat. 9.), which is hereinafter referred to as the Revenue Act of 1926, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury, the defendant, Douglas Fairbanks, on or about March 14, 1928, filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1927, upon Form 1040, commonly known as an Individual Income Tax Return.

V.

That in his said income tax return for the calendar year 1927, the defendant, Douglas Fairbanks, reported a net income of \$50,817.31, and a capital net gain of \$1,600,000.00 received from the Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year 1927, from which defendant took no deduction for cost, and which was returned for taxation at the capital gain rate of 12 1/2%, for said year 1927, and said return disclosed a tax due thereon in the amount of \$205,113.99 which was duly assessed by the United States Commissioner of Internal Revenue on his 1928 Serial or Account Number 304130 Assessment List and was paid by the defendant in quarterly installments of \$51,278.50 each on March 12, 1928, June 14, 1928, September 13, 1928 and December 14, 1928.

VI.

That thereafter and on or about August 29, 1930, the defendant, Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue a claim and application for the refund of \$53,231.55 of the sum paid by him as income taxes for the taxable year 1927 and in said claim alleged as a ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts and Disbursements basis and Income Tax returns filed accordingly.

"At conferences with a Special Conference Committee held during March - 1919 Washington, D. C., it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year and 5% the fourth year.

"On March 5th, 1925, I exchanged my interests in various completed motion pictures and other assets for \$4,000,000.00 par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of The Elton Corporation. The value of the pictures and other assets exchanged was established in my agreement with the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7, 1930, at \$1,096,445.52.

"On April 5th, 1927, and subsequently thereto, during the year 1927, the Elton Corporation called and paid me for \$1,600,000.00 par value debenture bonds. Inasmuch as my income tax returns have been filed on a Cash Receipts and Disbursements basis and consequently the

entire cost of pictures deducted from my income within the years expended, I treated the entire \$1,600,000.00 as capital net gain and so reported same on my 1927 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927, as stated above, and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$1,600,000.00 is to \$4,000,000.00 as cost of said bonds redeemed. Since \$1,600,000.00 is 40% of \$4,000,000.00 and 40% of \$1,096,445.52 is \$438,578.21, there remains \$1,161,421.79 capital net gain instead of \$1,600,000.00 as originally reported.

"The tax on this capital net gain is to be offset by the disallowance of deductions claimed against ordinary income in the amount of \$8,271.97 as reflected in Revenue Agent, L. E. Fellers' report dated August 7, 1930, leaving a net overpayment of \$53,231.55.

"Refund of interest on the overpayment is also claimed under provision of Section #614, Revenue Act of 1928."

VII.

That thereafter an audit was made of the defendant's said 1927 return, in connection with said claim for refund, under the direction of the Commissioner of Internal Revenue. As a result thereof, the Commissioner of Internal Revenue determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1927 in the amount of \$438,578.21, being the proportionable amount of cost attributable to the capital gain so reported, with a corresponding reduction in his

capital gain tax returned and a reduction in his total tax liability.

VIII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 2155767 was duly scheduled by the Commissioner of Internal Revenue on overassessment Schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in defendant's 1927 return in the amount of \$53,231.55, as tax, and \$9,795.05 as interest, which said amounts were erroneously determined to be refundable as an overpayment of defendant's 1927 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from the Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year, 1927, constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr., v. Commissioner, 27 B. T. A. 463, and not capital gain, but that the gross income of \$1,600,000.00 received from said source should be reduced by the sum of \$438,578.21, representing the proportionate cost of the particular bonds redeemed by the said Elton Corporation during the year 1927. The result of said redetermination of defendant's tax liability for the year 1927 discloses a deficiency in the tax reported upon his return in the amount of \$91,160.64 instead of an overpayment of tax in the sum of \$53,231.55 as previously determined by the Commissioner of Internal Revenue.

X.

That said claim for refund of \$53,231.55 of the sum paid by the defendant, Douglas Fairbanks, as a tax upon his reported net income and capital gains for the calendar year 1927 was through mistake and error as to the applicable taxing statute mistakenly and erroneously allowed by the United States Commissioner of Internal Revenue, and said amount of \$53,231.55 of said 1927 taxes, together with interest thereon in the sum of \$9,795.05 were, on January 26, 1932, erroneously refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$1,600,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1927. That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in allowing defendant's claim for refund of a portion of his 1927 taxes as set forth above, the said sum of \$53,231.55 and interest thereon in the amount of \$9,795.05 were mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1927 when the refund was made.

XII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928, (45 Stat.

791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon. - -

XIII.

That defendant, though liable to repay said sum of \$53,231.55 with interest thereon in the amount of \$9,795.05, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sum, or any part thereof to the plaintiff. That no part of said sum has been repaid or paid to the plaintiff by the defendant, or by any person or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$53,231.55, with interest thereon in the amount of \$9,795.05, on account of the refund so made on or about the 26th day of January, 1932.

SECOND CAUSE OF ACTION.

Plaintiff sues the defendant in this, its second cause of action, for money had and received in the sum of \$8,439.78 with interest thereon as provided by law until paid and says for its second cause of action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood in the County of Los Angeles, State of California, within the jurisdiction of this Court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes", approved May 29, 1928 (45 Stats. 791-875), which is hereinafter referred to as the Revenue Act of 1928, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the Approval of the Secretary of the Treasury, the defendant, Douglas Fairbanks, on or about March 12, 1929, filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1928, upon Form 1040, commonly known as an Individual Income Tax Return. Defendant filed an Amended Individual Income Tax Return upon Form 1040 on July 12, 1929, for said Calendar Year.

V.

That in his said income tax returns for the calendar year 1928 the defendant, Douglas Fairbanks, reported a net income of \$69,024.72, a capital net gain of \$150,000.00 received from the Elton Corporation, in redemption and retirement of that amount of its corporate bonds at par value during the calendar year of 1928, from which defendant took no deduction for cost, and which was re-

turned for taxation at the capital gain rate of 12 1/2% for said year 1928, and said original income tax return disclosed a tax due thereon in the amount of \$28,878.66 which was duly assessed by the United States Commissioner of Internal Revenue on his 1929 Assessment List, Serial or Account Number 303283 and was paid by the defendant in quarterly installments of \$7,219.67 or \$7,219.66 each on March 12, 1929, June 14, 1929, September 13, 1929 and December 14, 1929.

VI.

That thereafter and on or about August 29, 1930, the defendant Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue a claim and application for the refund of \$7,507.38 of the sum paid by him as income taxes for the taxable year 1928 and in said claim alleged as a ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts and Disbursements basis and Income Tax returns filed accordingly.

"At conferences with a Special Conference Committee held during March - 1929 in Washington, D. C., it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year, and 5% the fourth year.

"On March 5th, 1925, I exchanged my interests in various completed motion pictures and other assets for \$4,000,000.00 par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of the Elton Corporation. The value of the pictures and assets exchanged was established in my agreement with

the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7, 1930, at \$1,096,445.52.

"During the year 1928, the Elton Corporation called and paid me for \$150,000.00 par value debenture bonds. Inasmuch as my income tax returns have been filed on a Cash Receipts and Disbursements basis and consequently the entire cost of pictures deducted from my income within the years expended, I treated the entire \$150,000.00 as capital net gain and so reported same on my 1928 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927 and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$150,000.00 is to \$4,000,000.00 as cost of said bonds redeemed. Since \$150,000.00 is 3.75% of \$4,000,000.00 and 3.75% of \$1,096,445.52 is \$41,116.71, there remains \$108,883.29 capital net gain instead of \$150,000.00 as originally reported.

"In addition to this decrease in capital net gain, additional deductions are claimed against ordinary net income in the net amount of \$11,136.55, as reflected in Revenue Agent L. E. Fellers' report dated August 7, 1930. Of this amount \$10,747.49 is deduction from ordinary net income as reflected in my amended return. This leaves a net overpayment for 1928 of \$7,507.38.

"Refund of interest on the overpayment is also claimed under provision section #614, Revenue Act of 1928."

VII.

That thereafter an audit was made of the defendant's said 1928 returns, in connection with said claim for refund, under the direction of the Commissioner of Internal Revenue. As a result thereof, the Commissioner of Internal Revenue determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1928 in the amount of \$41,116.71, being the proportionable amount of cost attributable to the capital gain so reported, with a corresponding reduction in his capital gain tax returned and a reduction in his total tax liability.

VIII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 2,155,721 was duly scheduled by the Commissioner of Internal Revenue on overassessment schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in defendant's 1928 return in the amount of \$7,507.38 as tax and \$932.40 as interest, which said amounts were erroneously determined to be refundable as an overpayment of defendant's 1928 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from the Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year 1928 constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr. v. Commissioner, 27 B. T. A. 463, and not capital gain, but that the gross income of \$150,000.00 received from said source

should be reduced by the sum of \$41,116.71, representing the proportionate cost of the particular bonds redeemed by the said Elton Corporation during the year 1928.

X.

That said claim for refund of \$7,507.38 of the sum paid by the defendant, Douglas Fairbanks, as a tax upon his reported net income and capital gains for the calendar year 1928 was through mistake and error as to the applicable taxing statute mistakenly and erroneously allowed by the United States Commissioner of Internal Revenue, and said amount of \$7,507.38 of said 1928 taxes, together with interest thereon in the sum of \$932.40 were, on January 26, 1932, erroneously refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$150,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1928. That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in allowing defendant's claim for refund of a portion of his 1928 taxes as set forth above, the said sum of \$7,507.38 and interest thereon in the amount of \$932.40 were mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1928 when the refund was made.

XII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928, (45 Stat. 791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon.

XIII.

That defendant, though liable to repay said sum of \$7,507.38 with interest thereon in the amount of \$932.40, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sum, or any part thereof to the plaintiff. That no part of said sum has been repaid or paid to the plaintiff by the defendant, or by any person or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$7,507.38, with interest thereon in the amount of \$932.40, on account of the refund so made on or about the 26th day of January, 1932.

THIRD CAUSE OF ACTION.

Plaintiff sues the defendant in this, its Third Cause of Action, for money had and received in the sum of \$720.56 with interest thereon as provided by law until paid and says for its Third Cause of Action:

I.

That at all times hereinafter mentioned the plaintiff was and now is a corporation sovereign and body politic.

II.

That the defendant, Douglas Fairbanks, is a citizen of the United States and a resident of the City of Hollywood, in the County of Los Angeles, State of California, within the jurisdiction of the court.

III.

That this is a suit at law by the United States, of a civil nature, arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

IV.

That under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes," approved May 29, 1928 (45 Stat. 791-875), which is hereinafter referred to as the Revenue Act of 1928, and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury the defendant, Douglas Fairbanks, on or about March 14, 1930, filed with the Collector of Internal Revenue for the Sixth Internal Revenue Collection District of California, an income tax return for the calendar year 1929, upon Form 1040, commonly known as an Individual Income Tax Return.

V.

That in his said income tax return for the calendar year 1929 the defendant, Douglas Fairbanks, reported a net income of \$26,204.28, a capital net gain of \$150,000.00

received from The Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year 1929, from which he took a deduction for cost in the amount of \$34,823.65, that being the proportionate amount of cost attributable to the capital gain received, and reported the balance of \$115,176.35 for taxation at the capital gain rate of 12½%, for said year 1929, and said income tax return disclosed a tax due thereon in the amount of \$54,135.85 which was duly assessed for the United States Commissioner of Internal Revenue on his 1930 Assessment List, Serial or Account Number 302363 and was paid by the defendant in quarterly installments of \$13,533.97 on March 1, 1930, June 14, 1930, September 15, 1930 and December 15, 1930.

VI.

That thereafter and on or about August 2, 1930, the defendant, Douglas Fairbanks, duly filed and submitted to the said Collector of Internal Revenue a claim for refund which was not accepted as such, but as additional information to be attached to defendant's income tax return for the calendar year 1928.

VII.

That thereafter an audit was made of the defendant's said 1929 return under the direction of the Commissioner of Internal Revenue. As a result thereof the Commissioner of Internal Revenue determined that the defendant was entitled to a refund for the calendar year 1929.

VIII.

As a result of the determination mentioned above, a Certificate of Overassessment numbered 1256718, was duly scheduled by the Commissioner of Internal Revenue

on Overassessment Schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in the amount of \$677.57 as tax and \$42.99 as interest, which said amounts were erroneously determined to be refundable as an overpayment of defendant's 1929 tax.

IX.

That it was subsequently determined by the Commissioner of Internal Revenue that the amount received from The Elton Corporation by the defendant, Douglas Fairbanks, during the calendar year 1929, constituted income to him under the decision of the United States Board of Tax Appeals in the case of John H. Watson, Jr., v. Commissioner, 27 B. T. A. 463, and not capital gain.

X.

That through mistake and error as to the applicable taxing statute, the United States Commissioner of Internal Revenue mistakenly and erroneously allowed the said amount of \$677.57 of said 1929 taxes, together with interest thereon in the sum of \$42.99 as an overassessment of defendant's tax for the taxable year 1929 and said sums were on January 26, 1932, erroneously refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury, numbered 725,950, in payment, among others, of said refund.

XI.

That the Commissioner of Internal Revenue was mistaken as to the taxing statute applicable to the item of \$150,000.00 received by the defendant, Douglas Fairbanks, from the Elton Corporation during the calendar year 1929. That by virtue of the mistaken and erroneous action of the said Commissioner of Internal Revenue in

refunding a portion of the defendant's 1929 tax, as set forth above, the said sum of \$677.57 and interest thereon in the amount of \$42.99 was mistakenly, erroneously and unlawfully paid out of the Treasury of the United States to the defendant and received by him, when said sums were not due and did not belong to the said Douglas Fairbanks. That the defendant had not paid the total tax due from him for the year 1929 when the refund was made.

XII.

That under the provisions of Section 610(b) of the Revenue Act of 1928, approved May 29, 1928 (45 Stat. 791-875) plaintiff is entitled to maintain this action for the recovery of the money so mistakenly, erroneously and illegally paid and refunded to the defendant, Douglas Fairbanks, together with interest thereon. That under said Section of the Revenue Act, plaintiff is further entitled to recover an additional amount of \$7,322.10, together with interest thereon from the 15th day of March, 1930, from defendant.

XIII.

That defendant, though liable to repay said sum of \$677.57 with interest thereon in the amount of \$42.99, and though requested to do so, has failed, neglected and refused and still fails, neglects and refuses to repay or pay the said sums, or any part thereof to the plaintiff. That none of said sums or any part thereof have been repaid or paid to the plaintiff by the defendant, or by any persons or persons acting for or on behalf of the defendant. That there now remains due and wholly unpaid from the defendant, Douglas Fairbanks, to the plaintiff, United States of America, the sum of \$677.57, with interest thereon in the amount of \$42.99, on account of the refund so made on or about the 26th day of January, 1932.

WHEREFORE, Plaintiff prays judgment against the defendant as follows:

1. For the sum of \$63,026.60 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;
2. For the sum of \$8,439.78 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;
3. For the sum of \$720.56 with interest thereon from January 26, 1932, to date of judgment at the rate of six per cent (6%) per annum;
4. For plaintiff's costs and disbursements in this action expended.

Peirson M. Hall

E. H.

PEIRSON M. HALL

United States Attorney

Alva C. Baird

E. H.

ALVA C. BAIRD

Assistant U. S. Attorney

Jack L. Powell

E. H.

JACK L. POWELL

Assistant U. S. Attorney

Eugene Harpole

EUGENE HARPOLE,

Special Attorney,

Bureau of Internal Revenue.

Attorneys for Plaintiff.

[Endorsed]: Received copy of the within Amended Comp. this 11 day of May 1934 Mott, Vallee & Grant by Paul Vallee Attorney for Deft. Filed May 23, 1934 R. S. Zimmerman Clerk By L. Wayne Thomas Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ANSWER

Defendant, Douglas Fairbanks, by his attorneys, MOTT, VALLEE & GRANT, answering amended complaint of plaintiff, respectfully alleges:

ANSWERING PLAINTIFF'S FIRST CAUSE OF ACTION:

FIRST: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph III of the first cause of action of plaintiff's complaint.

SECOND: Defendant denies each and every allegation of Paragraph V of the first cause of action of plaintiff's complaint, except that defendant admits that in his income tax return for the calendar year 1927, the defendant Douglas Fairbanks reported a net income of \$50,817.31 and a capital net gain of \$1,600,000. and defendant further admits the said return disclosed a tax return due thereon of \$205,113.99, which was duly assessed and paid by defendant in quarterly installments of \$51,278.50 each on March 12, 1928, June 14, 1928, September 13, 1928, and December 14, 1928.

THIRD: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph VII of the first cause of action of plaintiff's complaint, except that defendant admits that defendant was entitled to a reduction in his capital net gain return for the year 1927 in the amount of \$438,578.21.

FOURTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations

contained in Paragraph VIII of the first cause of action of plaintiff's complaint, except that defendant admits that the Commissioner of Internal Revenue determined an overassessment in the defendant's 1927 income tax liability in the amount of \$53,231.55, with interest thereon of \$9795.05.

FIFTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations contained in Paragraph IX of the first cause of action of plaintiff's complaint.

SIXTH: Defendant denies each and every allegation of Paragraph X of the first cause of action of plaintiff's complaint, except that defendant admits that the claim for refund of \$53,231.55 of the sum paid by the defendant as a tax upon his reported net income and capital gains for the calendar year 1927 was allowed by the United States Commissioner of Internal Revenue, and that said amount of \$53,231.55 of said 1927 taxes, together with interest thereon in the sum of \$9795.05 was refunded to the defendant.

SEVENTH: Defendant denies each and every allegation of Paragraphs XI and XII of the first cause of action of plaintiff's complaint.

EIGHTH: Defendant denies each and every allegation of paragraph XIII of the first cause of action of plaintiff's complaint, except that defendant admits that neither the sum of \$53,231.55 with interest thereon in the amount of \$9795.05, nor the sum of \$91,160.64 with interest thereon has been repaid or paid to the plaintiff by the defendant or by any person or persons acting for or on behalf of the defendant.

ANSWERING PLAINTIFF'S SECOND CAUSE OF
ACTION:

FIRST: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph III of the second cause of action of plaintiff's complaint.

SECOND: Defendant denies each and every allegation of Paragraph V of the second cause of action of plaintiff's complaint, except that defendant admits that in his income tax return for the calendar year 1928, the defendant Douglas Fairbanks reported a net income of \$69,024.72, and a capital net gain of \$150,000.00 and defendant further admits the said return disclosed a tax return due thereon of \$28,878.66 which was duly assessed and paid by the defendant in quarterly installments of \$7,219.67 or \$7,219.66 each on March 12, 1929, June 14, 1929, September 13, 1929 and December 14, 1929.

THIRD: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph VII of the second cause of action of plaintiff's complaint, except that defendant admits that defendant was entitled to a reduction in his capital net gain return for the year 1928 in the amount of \$41,116.71.

FOURTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations contained in Paragraph VIII of the second cause of action of plaintiff's complaint, except that defendant admits that the Commissioner of Internal Revenue determined an overassessment in the defendant's 1928 income tax liability in the amount of \$7,507.38, with interest thereon of \$932.40.

FIFTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph IX of the second cause of action of plaintiff's complaint.

SIXTH: Defendant denies each and every allegation of Paragraph X of the second cause of action of plaintiff's complaint, except that defendant admits that the claim for refund of \$7,507.38 of the sum paid by the defendant as a tax upon his reported net income and capital gains for the calendar year 1928 was allowed by the United States Commissioner, and that said amount of \$7,507.38 of said 1928 taxes, together with interest thereon in the sum of \$932.40 was refunded to the defendant.

SEVENTH: Defendant denies each and every allegation of Paragraphs XI and XII of the second cause of action of plaintiff's complaint.

EIGHTH: Defendant denies each and every allegation of Paragraph XII of the second cause of action of plaintiff's complaint, except that defendant admits that neither the sum of \$7,507.38 with interest thereon in the amount of \$932.40, nor the sum of \$5,257.43, with interest thereon has been repaid or paid to the plaintiff by the defendant or by any person or persons acting for or on behalf of the defendant.

ANSWERING PLAINTIFF'S THIRD CAUSE OF ACTION.

FIRST: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph III of the third cause of action of plaintiff's complaint.

SECOND: Defendant denies each and every allegation of Paragraph V of the third cause of action of plaintiff's complaint, except that defendant admits that in his income tax return for the calendar year 1929, the defendant Douglas Fairbanks reported a net income of \$26,204.28, and a capital net gain of \$150,000.00 and defendant further admits the said return disclosed a tax return due thereon of \$54,135.85 which was duly assessed and paid by the defendant in quarterly installments of \$13,533.97 each on March 1st, 1930, June 14, 1930, September 15, 1930 and December 15, 1930.

THIRD: Defendant denies any information or belief sufficient to form a belief as to the allegations of paragraph VI of the third cause of action of plaintiff's complaint except that defendant admits that he duly appeared and submitted to the said Collector of Internal Revenue a claim for refund.

FOURTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph VII of the third cause of action of plaintiff's complaint, except that defendant admits that defendant was entitled to a reduction in his capital net gain return for the year 1929.

FIFTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations contained in Paragraph VIII of the third cause of action of plaintiff's complaint, except that defendant admits that the Commissioner of Internal Revenue determined an over-assessment in the defendant's 1929 income tax liability in the amount of \$677.57, with interest thereon of \$42.99.

SIXTH: Defendant denies any knowledge or information sufficient to form a belief as to the allegations of Paragraph IX of the third cause of action of plaintiff's complaint.

SEVENTH: Defendant denies each and every allegation of Paragraph X of the third cause of action of plaintiff's complaint, except that defendant admits that the claim for refund of \$677.57 of the sum paid by the defendant as a tax upon his reported net income and capital gains for the calendar year 1929 was allowed by the United States Commissioner of Internal Revenue, and that said amount of \$677.57 of the said 1929 taxes, together with interest thereon in the sum of \$42.99 was refunded to the defendant.

EIGHTH: Defendant denies each and every allegation of paragraphs XI and XII of the third cause of action of plaintiff's complaint.

NINTH: Defendant denies each and every allegation of Paragraph XIII of the third cause of action of plaintiff's complaint, except that defendant admits that neither the sum of \$677.57 with interest thereon in the amount of \$42.99, nor the sum of \$7,322.10 with interest thereon has been repaid or paid to the plaintiff by the defendant or by any person or persons acting for or on behalf of the defendant.

MOTT, VALLEE & GRANT,
by Paul Vallee,

Attorneys for Defendant,

1215 Citizens National Bank Building,
Los Angeles, California.

STATE OF CALIFORNIA }
 County of Los Angeles } ss.

CLARENCE E. ERICKSEN being by me first duly sworn, deposes and says: that he is the manager of the business affairs of the defendant Douglas Fairbanks, and as such, the facts herein stated are within his knowledge; that he has read the foregoing Answer and knows the contents thereof; and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true. That he makes this verification for and on behalf of the defendant, Douglas Fairbanks, for the reason that the defendant, Douglas Fairbanks, is now without the United States of America.

C. E. Ericksen

Subscribed and sworn to before me this 29th day of June, 1934.

[Seal]

Oraetta G. Ehlers

Notary Public in and for the County of Los Angeles,
 State of California.

[Endorsed]: Received copy of the within Answer this 29th day of June, 1934 Eugene Harpole Special Attorney for plaintiff. Filed Jun. 29, 1934. R. S. Zimmerman Clerk By L. Wayne Thomas, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

MOTION FOR JUDGMENT

Comes now the defendant in the above entitled action, through his attorneys, DENNIS F. O'BRIEN, ARTHUR F. DRISCOLL, PAUL VALLEE and JOHN B. MILLIKEN, and moves the Court for judgment in his behalf.

Defendant bases his said motion upon the ground and for the reason that the evidence before the Court will sustain no other conclusion than judgment for defendant on each of the causes of action presented.

DATED: September 5, 1936.

Dennis F. O'Brien

Dennis F. O'Brien

Arthur F. Driscoll

Arthur F. Driscoll

Paul Vallee

Paul Vallee

John B. Milliken

John B. Milliken

ATTORNEYS FOR DEFENDANT.

[Endorsed]: Filed Sep. 5, 1936. R. S. Zimmerman,
Clerk. By Murray E. Wire, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

OPINION AND ORDER.

The United States sues to recover a large amount of money from defendant, alleged to be due in part to the improper refunding of income tax amounts for the years 1927, 1928 and 1929, and in the main because of the assessment of an insufficient total amount in the first instance. In other words, the suit seeks recovery of tax amounts in excess of those assessed before the claim for refund was made and allowed. The case presents but one point for decision, and that is as to the proper construction to be given to the provisions of the Revenue Statute which permit the taxpayer to have capital net gain used as the basis for assessment after ordinary net income is calculated. Section 101 of the Revenue Act of 1928 (similar provisions were incorporated in the Act of 1926 applicable to the year 1927) provides: "101. In the case of any taxpayer other than a corporation, who for any taxable year derives a capital net gain (as hereafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall be first computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain." Subdivision (c) (1) defines capital net gain to be, "taxable gain from the sale or exchange of capital

assets consummated after December 31, 1921," and capital assets is defined (subdivision (c) subsection (8)), as: "Property held by the taxpayer for more than two years (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business."

The taxpayer in this case had reported for the respective years mentioned capital net gain, and his assessments had been calculated under the above provisions of the law. He took no account of cost, and later a readjustment was made and he was allowed a refund in a large total amount. The United States by this suit asserts that the method of computation by the capital gain formula was wholly erroneous, and that instead of there having been any rebatable credit, the taxpayer in fact should have paid a larger amount than that first assessed.

The facts are undisputed. In the year 1925 the defendant, a motion picture actor and producer, sold his rights in eight motion pictures produced by him to Elton Corporation for a consideration of \$4,000,000.00. He at the time received as consideration debentures of the corporation for the face amount, plus 990 shares of no par value stock of the same corporation. The cost value of the pictures was ascertained to be \$1,096,445.52. The bonds of the Elton Corporation were to mature over a term of

years, and were callable at the option of the issuing corporation. Bonds were called during the year 1927 in the amount of \$1,600,000.00, and the taxpayer received cash therefor. Other amounts were returned by the Elton Corporation in 1928 and 1929 on the same account.

The Commissioner had ruled during years prior to 1929 and under the provisions of the law, the construction of which is here in question, that when an obligation held in favor of the taxpayer, such as bonds, matured and was paid, the transaction constituted neither a sale nor exchange of capital assets. In February, 1929, the Board of Tax Appeals had before it the case of Werner (15 B. T. A. 482). Werner had held certain 20-year convertible bonds of a corporation which he purchased in 1920 for \$8,870.00. In May, 1923, the issuing corporation called the bonds for redemption and Werner received \$11,000.00 cash. He reported a profit of \$2,130.00 in his income tax return for the year 1923 as "capital gain" and accounted for the same claiming the right to have the tax upon the gain computed at $12\frac{1}{2}\%$ as was provided by the applicable statute. The Commissioner denied his claim and the Board of Tax Appeals, by Chairman Littleton, reversed the Commissioner's ruling, saying:

"We are of opinion that the redemption of these bonds constituted a 'sale or exchange' within the meaning of Section 206. Apparently no attempt was made to limit the character of transactions to which Section 206 should apply."

Following that decision the Commissioner revised his computing rule to correspond with the holding, and announced a new one. In his revised regulations he provided that net gain from bonds "whether received as the result of the maturity of the bonds or as a result of their redemption before maturity, may, in the option of the taxpayer * * *, be taxed under the provisions of Section 206 * * *."

The same question was presented to the Board of Tax Appeals in December, 1932. Commissioner Van Fossan wrote the opinion, which completely reversed the conclusion announced in the Werner case. The case was that of John H. Watson, Jr., reported in 27 B. T. A. 463. The Board there said:

"On further consideration we are of the opinion that the Board erred in its holding in Henry P. Werner, supra. It is elemental that where a statute is clear and unambiguous in its terms and provisions resort should not be had to legislative history to determine the limits of its compass. The statute in question is so simple in construction and so clear in meaning that it justifies no resort to the Congressional Committee's reports as an aid in the interpretation thereof.

The words 'sale or exchange' are ordinary words of well established meaning. Taken in their context they are susceptible of no misconstruction. Payment of the amount specified in the bonds, either at maturity or pursuant to an authorized call prior to maturity, is not a 'sale or ex-

change' of such bonds. It is merely the payment of an obligation according to its fixed terms. For these reasons we believe the decision in Henry P. Werner, supra, was erroneous, and it is accordingly overruled.

In the instant case there was neither a 'sale' nor an 'exchange' of a capital asset when the Liberty Bonds were paid at maturity. It was the satisfaction of an obligation of the United States by payment. Loss incurred or gain realized in such a transaction is not a capital loss or a capital gain under the definition found in the statute."

This ruling was later reaffirmed in the matter of Braun, Trustee, 29 B. T. A. 1161, February 23, 1934.

A thorough study of the question submitted, and notwithstanding the very able argument of counsel for defendant as contained in the briefs filed, has led me to the conclusion that the position of the Revenue Department should be upheld. The reasoning of the Board of Tax Appeals as expressed in the Watson case, supra, seems logical and consistent with the plain meaning of the applicable law.

Findings and Judgment will be for the plaintiff, and an exception is noted in favor of the defendant.

Dated March 18, 1936.

Wm. P. James

U. S. District Judge.

[Endorsed]: Filed Mar. 18, 1936. R. S. Zimmerman, Clerk. By Murray E. Wire, Deputy Clerk.

At a stated term, to-wit: The February Term, A. D. 1936, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Saturday the 5th day of September, in the year of our Lord one thousand nine hundred and thirty-six.

Present:

The Honorable WM. P. JAMES, District Judge.

United States of America,	(
	Plaintiff,)
vs.		(No. 6680-J Law.
Douglas Fairbanks,)
	Defendant.	(

This cause coming before the court for hearing motion of defendant to set aside and vacate opinion, judgment and stipulation; and to grant new trial and restore case to calendar, filed July 9, 1936; Alva C. Baird, Assistant U. S. Attorney, appearing as counsel for the government, John B. Milliken, Esq. appearing for the defendant, and A. M. Randol being present as the official stenographic reporter of the proceedings:

J. B. Milliken, Esq. argues in support of said Motion and argues the matter of the interest to be allowed on the refund:

A. C. Baird, Esq. states that the complaint or answer does not allege the date of the demand for refund, and states objections to the granting of the defendant's said motion.

The Court orders the judgment heretofore entered herein, vacated. Exception is allowed to the plaintiff to this order.

J. B. Milliken, Esq. reoffers the entire testimony heretofore taken at the trial of this case, together with all exhibits received in evidence;

A. C. Baird, Esq. states he has no objection if the entire record is considered;

J. B. Milliken, Esq. states that it is so understood;

The Court so orders;

A. C. Baird, Esq. thereupon offers as plaintiff's exhibit, the following, and the court orders same admitted in evidence, being marked

Plf's. Exhibit 13: letter dated July 6, 1933, John P. Carter, Collector of Int. Rev. to Douglas Fairbanks.

J. B. Milliken, Esq. now moves for judgment on behalf of defendant and files said motion in writing;

A. C. Baird, Esq. now renews motion for judgment in this case for plaintiff;

J. B. Milliken, Esq. offers Special Findings of Fact, being 36 in number;

A. C. Baird, Esq. states separately plaintiff's objections to proposed findings of defendant which are submitted in writing, and the Court separately orders each of said objections overruled, and an exception is allowed and noted as to each of said orders;

J. B. Milliken, Esq. presents proposed Special Conclusions of Law in writing and same are filed herein:

A. C. Baird, Esq. offers Conclusions of law on behalf of plaintiff, and same are filed herein;

J. B. Milliken, Esq. presents to the Court copy of opinion of case U. S. vs. Carpenter, decided by U. S. Circuit Court of Appeals, 10th Circuit, July 11, 1936, and same is filed herein;

J. B. Milliken, Esq. argues further on the matter of the allowance to plaintiff of interest on the refund, and contends that plaintiff should not be allowed interest, but that if any interest is allowed, it should be from the date of demand of plaintiff;

A. C. Baird, Esq. argues further the matter of the allowance of interest on the refund, and asks time to file brief thereon; and moves for judgment for the plaintiff;

The Court thereupon allows the Special Findings of Fact and signs same, which are now filed herein. The Motion on behalf of defendant for judgment is ordered denied. Exception allowed. The Conclusions of Law offered on the part of the defendant are ordered refused. Exception allowed. The judgment is ordered in favor of the plaintiff, except the Court will consider further the matter of interest before the judgment is entered;

The plaintiff is allowed ten days to file brief on the matter of the allowance to plaintiff of interest on the judgment to be entered, and the defendant is allowed ten days to file reply brief;

A. C. Baird, Esq. moves that the opinion of the court heretofore filed herein, be made to conform to the case as now submitted, and the Court so orders, except as to the matter of interest, and states that if the Court decides differently same will be so amended.

[TITLE OF COURT AND CAUSE.]

SPECIAL FINDINGS OF FACT

This cause came on regularly for trial on the 5th day of September, 1936, before the Court sitting without a jury, a trial by jury having been waived by written stipulation of the parties hereto; plaintiff appearing by ALVA C. BAIRD, Assistant United States Attorney for said district, and the defendant appearing by his counsel, DENNIS F. O'BRIEN, ARTHUR F. DRISCOLL, PAUL VALLEE and JOHN B. MILLIKEN; and evidence, both oral and documentary, having been received and the Court having fully considered the same, makes the following Special Findings of Fact:

I.

The plaintiff is a corporation sovereign and politic.

II.

The defendant Douglas Fairbanks is a citizen of the United States and a resident of Hollywood, County of Los Angeles, State of California, within the jurisdiction of this court.

III.

This is a suit at law by the United States of a civil nature arising in connection with the administration of the law of Congress providing for Internal Revenue, and this action is commenced and maintained at the request and authorization of the Commissioner of Internal Revenue, and under the direction of the Attorney General of the United States.

IV.

Defendant has been engaged in the business of making motion pictures at all times since the year 1916.

V.

In 1925 defendant was the owner of eight completed motion pictures in addition to one in the process of making.

VI.

Under date of March 5, 1925 defendant made a contract with The Elton Corporation under the terms of which he transferred to The Elton Corporation all his right, title and interest in said motion pictures in exchange for \$4,000,000 par value debenture bonds and 990 shares of no par value stock of said corporation, said bonds being dated March 5, 1925 and maturing March 5, 1935. The cost basis to the defendant for income tax purposes of the pictures and other assets exchanged by defendant for bonds of The Elton Corporation of the face value of \$4,000,000 was \$1,096,445.52.

VII.

The aforesaid debenture bonds issued by The Elton Corporation contained the following provision:

"This debenture bond may be redeemed by the corporation at any time at its face value plus interest earned and unpaid hereon upon thirty days' notice to the registered holder hereof."

Said contract with The Elton Corporation dated March 5, 1925 contained a provision under which The Elton Corporation obligated itself to redeem \$100,000 face value of said bonds per year beginning three years after date of said contract, or after March 5, 1928.

VIII.

In 1927 said Elton Corporation did redeem and said defendant did surrender for redemption \$1,600,000 par value of said debenture bonds.

IX.

In the year 1928 the said Elton Corporation redeemed and defendant surrendered for redemption \$150,000 par value of said debenture bonds.

X.

In the year 1929 the said Elton Corporation did redeem and defendant did surrender for redemption \$150,000 par value of said debenture bonds.

XI.

At all times during said years there was pending between the plaintiff and defendant a controversy as to defendant's income taxes for the years 1917 to 1925 inclusive, during which years defendant had kept his books on a cash receipts and disbursements basis, and had expensed the cost of his motion pictures as made. Defendant contended in said controversy that under the laws in existence he was entitled so to do, and the plaintiff contended that the cost of said motion pictures should have been capitalized and amortized over a period of years.

XII.

During the pendency of said controversy, the defendant Douglas Fairbanks on or about March 14, 1928 filed with the Collector of Internal Revenue for the Sixth Internal Revenue District, California, an income tax return for the calendar year 1927 upon form 1040, commonly known as individual income tax return. Said return was prepared and filed under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes", approved February 26, 1926 (44 Stat. 9), and pursuant to the regulations duly promulgated under said Act by the Commis-

sioner of Internal Revenue with the approval of the Secretary of the Treasury.

XIII.

Said return was prepared and filed upon a cash receipts and disbursements basis.

XIV.

In his said income tax return for the calendar year 1927 the defendant Douglas Fairbanks reported a net income of \$50,817.31, and a capital net gain of \$1,600,000 received from The Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the calendar year 1927 as set forth in finding VIII above.

XV.

In said tax return for the year 1927 defendant took no deduction for cost against the said capital net gain of \$1,600,000 and the entire amount so received by him from The Elton Corporation during 1927 was returned for taxation at the capital gain rate of $12\frac{1}{2}\%$ and said return disclosed a tax due thereon in the amount of \$205,113.99, which was assessed by the United States Commissioner of Internal Revenue on his 1928 Serial or Account Number 30130 Assessment List and was paid by the defendant in quarterly instalments of \$51,278.50 each on March 12, 1928, June 14, 1928, September 13, 1928 and December 14, 1928.

XVI.

During the pendency of said controversy between the plaintiff and defendant as to defendant's income taxes for the years 1917 to 1926 inclusive, and on or about March 12, 1929 the defendant Douglas Fairbanks filed

with the Collector of Internal Revenue for the Sixth Internal Revenue District, California, an income tax return for the calendar year 1928 upon form 1040, commonly known as an individual income tax return. Defendant also filed an amended income tax return upon form 1040 on July 12, 1929 for said calendar year. Said return and amended return were prepared and filed under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes", approved May 29, 1928 (45 Stat. 791-875), and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury. Said return and amended return were prepared and filed on a cash receipts and disbursements basis.

XVII.

In said tax return for the calendar year 1928 defendant Douglas Fairbanks reported a net income of \$69,024.72 and a capital net gain of \$150,000 received from The Elton Corporation in redemption and retirement of that amount of its corporate bonds at par value during the year 1928, as set forth in finding IX above.

XVIII.

In said tax return for the calendar year of 1928 defendant took no deduction for cost against said capital net gain, and the entire amount so received by him from The Elton Corporation during the year 1928 was returned for taxation at the capital gain rate of $12\frac{1}{2}\%$, and said original tax return disclosed a tax due thereon in the amount of \$28,878.66 which was assessed by the United

States Commissioner of Internal Revenue on his 1929 assessment list, Serial or Account Number 303283, and was paid by the defendant in quarterly installments of \$7,219.67 or \$7,219.66 each on March 12, 1929, June 14, 1929, September 13, 1929 and December 14, 1929.

XIX.

In December 1929 a written agreement of settlement was made between plaintiff and defendant as to defendant's income taxes for the years 1917 to 1919 inclusive, and a separate written agreement of settlement was made between defendant and plaintiff as to defendant's income taxes for the years 1920 to 1926 inclusive.

XX.

As part of said settlements, defendant's income taxes for the years 1917 to 1926 inclusive were recomputed by the plaintiff. In the said recomputation the cost of defendant's motion pictures made during the said years of 1917 to 1926 inclusive were capitalized in the years that the expenditures were made and were amortized upon a formula agreed upon between the plaintiff and the defendant, namely, a deduction of 75% thereof in the first year after release of the motion picture; 15% during the second year after release; 5% during the third year after release, and 5% during the fourth year after release.

XXI.

As a result of said recomputation, defendant was required to pay and did pay to the plaintiff additional taxes for the years 1917 to 1926 inclusive in the sum of \$488,079.32, with interest amounting to \$207,761.21, or a total additional payment of \$695,840.53, leaving an unrecouped or unamortized cost of pictures of \$1,096,445.52 as of December 31, 1926.

XXII.

After the aforesaid settlement had been arrived at between the plaintiff and the defendant as to defendant's income taxes for the years 1917 to 1926 inclusive, but before plaintiff had definitely ascertained the amount of the unrecouped picture costs as of December 31, 1926, the defendant Douglas Fairbanks on or about March 14, 1930 filed with the Collector of Internal Revenue for the Sixth Internal Revenue District of California an income tax return for the calendar year 1929 upon form 1040, commonly known as an individual income tax return. In making said return, the defendant took the basis of capitalization and amortization upon which settlement had been made between the defendant and plaintiff, and estimated the unamortized cost of pictures as of December 31, 1926 to be \$928,630.87, and defendant took as cost against the amount received from The Elton Corporation in the redemption of debentures during the said calendar year that part of said sum of \$928,630.87 which the total received, or \$150,000, bore to the total issue of debentures, or \$4,000,000., or a cost of \$34,823.65. The balance of the \$150,000 received during the said calendar year of 1929 was reported as capital net gain. The said return was prepared and filed under the provisions of the Act of Congress entitled "An Act to reduce and equalize taxation, to provide revenue and for other purposes", approved May 29, 1928 (45 Stat. 791-875), and pursuant to the regulations duly promulgated under said Act by the Commissioner of Internal Revenue with the approval of the Secretary of the Treasury.

XXIII.

The said income tax return filed by Douglas Fairbanks for the calendar year 1929 reported a net income of \$26,-

204.28, in addition to the aforesaid capital net gain of \$150,000, from which costs in the amount of \$34,823.65 were deducted as hereinabove stated, leaving a balance of \$115,176.35 for taxation at the capital gain rate of 12½% for the year 1929, and said income tax return disclosed a tax due thereon in the amount of \$54,135.85, which was duly assessed by the United States Commissioner of Internal Revenue on his 1930 Assessment List, Serial or Account Number 302363 and was paid by the defendant in quarterly instalments of \$13,533.97 on March 1, 1930, June 14, 1930, September 15, 1930 and December 15, 1930.

XXIV.

Thereafter under date of August 7, 1930, one L. E. Fellers, revenue agent in the employ of the plaintiff, made a report of audit upon defendant's returns for the years 1927 to 1929 inclusive, and therein it was disclosed that the plaintiff had fixed the unamortized cost of the pictures as of December 31, 1926 at \$1,096,445.52 instead of \$928,630.87, as estimated and used by the defendant in his 1929 return above mentioned.

XXV

Said report of audit made by L. E. Fellers under date of August 7, 1930 treated the proceeds of the debentures of The Elton Corporation which defendant had reported for the years 1927, 1928 and 1929 as capital net gain in the same manner as the defendant had treated them in the returns filed.

XXVI.

Thereafter upon the basis of the unamortized cost of pictures as of December 31, 1926 of \$1,096,445.52, as fixed by plaintiff, and treating the proceeds of said debentures

tures as capital gain as was done in the Fellers' Audit, defendant caused to be prepared and filed claims for refunds for each of the years 1927, 1928 and 1929.

XXVII.

On or about August 29, 1930 the defendant Douglas Fairbanks duly filed and submitted to the said Collector of Internal Revenue a claim and application for refund of \$53,231.55 of the sum paid by him as income taxes for the taxable year 1927 and in said claim alleged as ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts and Disbursements basis and Income Tax returns filed accordingly.

"At conferences with a Special Conference Committee held during March 1929, Washington, D. C. it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year and 5% the fourth year.

"On March 5th, 1925 I exchanged my interests in various completed motion pictures and other assets for \$4,000,000.00 par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of The Elton Corporation. The value of the pictures and other assets exchanged was established in my agreement with the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7, 1930 at \$1,096,445.52.

"On April 5th, 1927, and subsequently thereto, during the year 1927, The Elton Corporation called and paid me for \$1,600,000. par value debenture bonds. Inasmuch as

my income tax returns have been filed on a Cash Receipts and Disbursements basis and consequently the entire cost of pictures deducted from my income within the years expended, I treated the entire \$1,600,000. as capital net gain and so reported same on my 1927 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927, as stated above, and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$1,600,000. is to \$4,000,000. as cost of said bonds redeemed. Since \$1,600,000. is 40% of \$4,000,000. and 40% of \$1,096,445.52 is \$438,578.21, there remains \$1,161,421.79 capital net gain instead of \$1,600,000. as originally reported.

"The tax on this capital net gain is to be offset by the disallowance of deductions claimed against ordinary income in the amount of \$8,271.97 as reflected in Revenue Agent L. E. Fellers' report dated August 7, 1930, leaving a net overpayment of \$53,231.55.

"Refund of interest on the overpayment is also claimed under provision of Section #614, Revenue Act of 1928."

XXVIII.

The aforesaid claim for refund was based upon the figure of \$1,096,445.52 fixed by the plaintiff as the unamortized cost of motion pictures as of March 1, 1925, and defendant charged against the proceeds of debentures received during 1927 totaling \$1,600,000, such part of the unamortized cost of \$1,096,445.52 as \$1,600,000. bore to \$4,000,000, the total par value of debentures received by defendant.

XXIX.

On or about August 29, 1930 the defendant Douglas Fairbanks duly filed and submitted to said Collector of Internal Revenue a claim and application for refund of \$7,507.38 of the sum paid by him as income taxes for the taxable year 1928, and in said claim alleged as a ground for recovery thereunder as follows:

"My accounts have been kept on a Cash Receipts and Disbursements basis and Income Tax returns filed accordingly.

"At conference with a Special Conference Committee held during March, 1929 in Washington, D. C., it was agreed that picture costs should be capitalized and amortized on the basis of 75% the first year from release date, 15% the second year, 5% the third year and 5% the fourth year.

"On March 5th, 1925, I exchanged my interests in various completed motion pictures and other assets for \$4,000,000. par value debenture bonds, payable over a period of ten years and 990 shares of no par value stock of The Elton Corporation. The value of the pictures and assets exchanged was established in my agreement with the Special Conference Committee and subsequently confirmed by the Commissioner and Internal Revenue Agent, L. E. Fellers, in his report of August 7, 1930, at \$1,-096,445.52.

"During the year 1928, The Elton Corporation called and paid me for \$150,000.00 par value debenture bonds. Inasmuch as my income tax returns have been filed on a Cash Receipts and Disbursements basis and consequently the entire cost of pictures deducted from my income within the years expended, I treated the entire \$150,000.00 as

capital net gain and so reported same on my 1928 income tax return and paid tax on same accordingly.

"Since my method of accounting was changed by the Bureau of Internal Revenue in final settlement of my income tax for years prior to 1927 and the value of the bonds and other assets established at \$1,096,445.52, I should be permitted to treat the percentage of \$1,096,445.52 that \$150,000. is to \$4,000,000. as cost of said bonds redeemed. Since \$150,000. is 3.75% of \$4,000,000. and 3.75% of \$1,096,445.52 is \$41,116.71, there remains \$108,883.29 capital net gain instead of \$150,000.00 as originally reported.

"In addition to this decrease in capital net gain, additional deductions are claimed against ordinary net income in the net amount of \$11,136.55 as reflected in Revenue Agent L. E. Fellers' report dated August 7, 1930. Of this amount \$10,747.49 is deduction from ordinary net income as reflected in my amended return. This leaves a net overpayment for 1928 of \$7,507.38.

"Refund of interest on the overpayment is also claimed under provisions section ~~6~~614, Revenue Act of 1928."

XXX.

The aforesaid claim for refund was based upon the figure of \$1,096,445.52 fixed by plaintiff as the unamortized cost of motion pictures as of March 1, 1925, and defendant charged against the proceeds of debentures received during 1928 amounting to \$150,000 such part of the unamortized cost of \$1,096,445.52 as \$150,000 bore to \$4,000,000 the total par value of debentures received by defendant.

XXXI.

On or about August 2, 1930 the defendant Douglas Fairbanks duly filed and submitted to the said Collector of Internal Revenue a claim for refund against his 1929 tax which was not accepted as such, but as additional information to be attached to defendant's income tax return for the year 1929.

XXXII.

The aforesaid claim for refund was based upon the figure of \$1,096,445.52 found by the plaintiff to be the unamortized cost of motion pictures as of March 1, 1925 and defendant charged against the proceeds of debentures received by him during 1929 amounting to \$150,000, such part of the unamortized cost of \$1,096,445.52 as that figure, namely, \$150,000 bore to the total par value of debentures amounting to \$4,000,000 received by defendant.

XXXIII.

Thereafter an audit was made of defendant's said returns for 1927, 1928 and 1929 in connection with the said claims for refund under the direction of the Commissioner of Internal Revenue. As a result thereof, the Commissioner of Internal Revenue determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1927 in the amount of \$438,578.21, being the proportionable amount of cost attributable to the capital gain so reported with a corresponding reduction in his capital gain tax returned and a reduction in his total tax liability. As a result thereof, the Commissioner of Internal Revenue also determined that the defendant was entitled to a reduction in his capital net gain returned for the year 1928 in the amount of \$41,116.71, being the proportionable amount of cost attributable to the capital gain

so reported with a corresponding reduction in his capital gain tax returned and a reduction in his total tax liability. As a result thereof, the Commissioner of Internal Revenue determined also that defendant was entitled to a reduction in his capital net gain returned for the year 1929 with a corresponding reduction in his capital gain tax return and a reduction in his total tax liability.

XXXIV.

As a result of the determination mentioned above, a certificate of overassessment No. 2,155,767 was duly scheduled by the Commissioner of Internal Revenue, on overassessment Schedule No. I. T. 44669, approved January 6, 1932, allowing an overassessment in defendant's 1927 return in the amount of \$53,231.55 as tax and \$9,795.05 as interest, and a certificate of overassessment No. 2,155,721 was duly scheduled by the Commissioner of Internal Revenue on overassessment Schedule No. I. T. 44669, approved January 6, 1932 allowing an overassessment in defendant's 1928 return in the amount of \$7,507.38 as tax and \$932.40 as interest, and a certificate of overassessment No. 1,256,718 was duly scheduled by the Commissioner of Internal Revenue on overassessment schedule No. I. T. 44669 approved January 6, 1932, allowing an overassessment in the amount of \$677.57 as tax, and \$42.99 as interest.

XXXV.

Defendant's claim for refund of \$53,231.55 of the sum paid by him as a tax upon his reported net income and capital gain for the calendar year 1927 was allowed by

the United States Commissioner of Internal Revenue, and said amount of \$53,231.55 of said 1927 taxes, together with interest thereon in the sum of \$9,709.05 were on January 26, 1932, refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury, No. 725,950 in payment among others of said refund, and defendant's claim for refund of \$7,507.38 of the sum paid by him as a tax upon his reported net income and capital gains for the calendar year 1928 was allowed by the United States Commissioner of Internal Revenue, and said amount of \$7,507.38 of said 1928 taxes, together with interest thereon in the sum of \$932.40 were, on January 26, 1932 refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury, No. 725,950 in payment among others of said refund, and the United States Commissioner of Internal Revenue likewise allowed the sum of \$677.56 of defendant's 1929 taxes, together with interest thereon in the sum of \$42.99 as an overassessment of defendant's taxes for the taxable year 1929, and said sums were on January 26, 1932 refunded to the defendant by delivery to him of the check of the Disbursing Clerk of the United States Treasury No. 725,950 in payment among others of said refund.

XXXVI.

That thereafter the Commissioner of Internal Revenue determined that the refunds made as above set forth were erroneous and did, through the Collector of Internal Revenue for the Sixth Collection District of California,

on July 6, 1933 officially demand the return to the Government of the sums paid to defendant on January 26, 1932. No part of said repayments by the government has been returned by the defendant to the Government or by any person or persons acting for or on behalf of defendant.

This cause of action was commenced and maintained at the request and authorization of the Commissioner of Internal Revenue and under the direction of the Attorney General of the United States.

DATED: Sept. 5 - 1936

Wm P James

UNITED STATES DISTRICT JUDGE

DENNIS F. O'BRIEN

ARTHUR F. DRISCOLL

PAUL VALLEE

Citizens Bank Building,
Los Angeles, California

and

JOHN B. MILLIKEN,

Bank of America Building,
Los Angeles, California

COUNSEL FOR DEFENDANT.

[Endorsed]: Filed Sep 5 - 1936 R. S. Zimmerman
Clerk By Murray E. Wire, Deputy Clerk.

At a stated term, to wit: The September Term, A. D. 1936, of the District Court of the United States of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles on Wednesday the 30th day of September in the year of our Lord one thousand nine hundred and thirty-six.

Present:

The Honorable Wm. P. James, District Judge.

UNITED STATES OF AMERICA,)

(

Plaintiff,)

vs.

No. 6680-I.

)

DOUGLAS FAIRBANKS,)

)

Defendant.)

The judgment heretofore entered in favor of the plaintiff as against the defendant was upon application of the defendant vacated, in order that the Court's determination that interest allowed in favor of the Government recoverable as of the date of the refund of the tax amount could be reconsidered. The Court now, after considering the briefs of counsel, is of the view and so decides that the interest should be calculated as from the date of the demand for the refund of the tax amount, to-wit: from July 6, 1933, and at the legal rate established by the State of California. Judgment is ordered accordingly, and an exception is noted in favor of the United States.

IN THE DISTRICT COURT OF THE UNITED
STATES IN AND FOR THE SOUTHERN
DISTRICT OF CALIFORNIA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)

Plaintiff,) No. 6680-J

v.)

) JUDGMENT

DOUGLAS FAIRBANKS,)

Defendant.)

The above-entitled cause came on regularly for trial on the 5th day of September, 1936, before the Court sitting without a jury, a jury having been expressly waived in writing, the plaintiff appearing by its attorneys, Peirson M. Hall, United States Attorney for the Southern District of California, E. H. Mitchell, Special Assistant United States Attorney, and Alva C. Baird, Assistant United States Attorney; the defendant appearing by Paul Vallee, Dennis F. O'Brien, Arthur F. Driscoll, and John B. Milliken, Esqs., and evidence both oral and documentary having been introduced, briefs having been filed, the cause having been submitted for decision, and the Court having heretofore made and caused to be filed herein its written Findings of Fact and Conclusions of Law, and being fully advised in the premises;

IT IS ORDERED, ADJUDGED AND DECREED that judgment be entered against the defendant and in favor of the plaintiff for the sum of \$72,186.94 (Seventy-two thousand one hundred eighty-six and 94/100 Dollars), together with interest thereon at the rate of 7% per annum from July 6, 1933 to and including October 5, 1936, the date of entry of judgment herein, in the sum of \$16,422.51 (Sixteen thousand four hundred twenty-two and 51/100 Dollars), together with costs and disbursements in favor of the plaintiff incurred in said action, as provided by law, and taxed by the Clerk of this Court in the sum of \$16.00.

Dated this 5th day of October, 1936.

Wm. P. James

UNITED STATES DISTRICT JUDGE.

Approved as to form according to Rule 44:

Paul Vallee

Attorneys for Defendant.

Judgment entered and recorded Oct. 5 - 1936

R. S. ZIMMERMAN Clerk

By Murray E. Wire, Deputy Clerk.

[Endorsed]: Filed Oct. 5, 1936. R. S. Zimmerman Clerk By Murray E. Wire, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

CONCLUSIONS OF LAW
(REQUESTED BY DEFENDANT)

This cause came on regularly for trial on the 5th day of September, 1936, before the Court sitting without a jury, a trial by jury having been waived by written stipulation of the parties hereto; plaintiff appearing by ALVA C. BAIRD, Assistant United States Attorney for said district, and the defendant appearing by his counsel, DENNIS F. O'BRIEN, ARTHUR F. DRISCOLL, PAUL VALLEE and JOHN B. MILLIKEN; and evidence, both oral and documentary, having been received and the Court having fully considered the same, makes the following Conclusions of Law and adopts the Conclusions of Law hereinafter indicated:

I.

That the surrender by the defendant of the said bonds of The Elton Corporation for redemption during the year 1927 was an exchange or sale of capital assets within the meaning of Section 208 of the Revenue Act of 1926. That the excess of the sum received by the defendant during the year 1927 upon the redemption of said bonds, over and above the cost basis to defendant of the bonds surrendered, was capital gain within the meaning of Section 208 of the Revenue Act of 1926 and was taxable to defendant at the rates and in the manner provided in said Section.

II.

That defendant overpaid his income taxes for the year 1927 in the amount refunded to him by the Commissioner of Internal Revenue; that all sums refunded to the defendant as overpayments of income taxes for the year 1927 and interest thereon were correctly and legally refunded.

III.

That the plaintiff is not entitled to recover from defendant any of the sums refunded to defendant as overpayments of income taxes for the year 1927 or interest thereon.

IV.

That the surrender by the defendant of the said bonds of The Elton Corporation for redemption during the year 1928 was an exchange or sale of capital assets within the meaning of Section 101 of the Revenue Act of 1928. That the excess of the sum received by the defendant during the year 1928 upon the redemption of said bonds, over and above the cost basis to defendant of the bonds surrendered, was capital gain within the meaning of Section 101 of the Revenue Act of 1928 and was taxable to defendant at the rates and in the manner provided in said Section.

V.

That defendant overpaid his income taxes for the year 1928 in the amount refunded to him by the Commissioner of Internal Revenue; that all sums refunded to the defendant as overpayments of income taxes for the year 1928 and interest thereon, were correctly and legally refunded.

VI.

That the plaintiff is not entitled to recover from defendant any of the sums refunded to defendant as overpayments of income taxes for the year 1928 or interest thereon.

VII.

That the surrender by the defendant of the said bonds of The Elton Corporation for redemption during the year 1929 was an exchange or sale of capital assets within the meaning of Section 101 of the Revenue Act of 1928.

That the excess of the sum received by the defendant during the year 1929 upon the redemption of said bonds, over and above the cost basis to defendant of the bonds surrendered, was capital gain within the meaning of Section 101 of the Revenue Act of 1928 and was taxable to defendant at the rates and in the manner provided in said Section.

VIII.

That defendant overpaid his income taxes for the year 1929 in the amount refunded to him by the Commissioner of Internal Revenue; that all sums refunded to the defendant as overpayments of income taxes for the year 1929 and interest thereon were correctly and legally refunded.

IX.

That the plaintiff is not entitled to recover from defendant any of the sums refunded to defendant as overpayments of income taxes for the year 1929 or interest thereon.

DATED: _____

UNITED STATES DISTRICT JUDGE.

Dennis F. O'Brien

Arthur F. Driscoll

Paul Vallee

Citizens Bank Building,

Los Angeles, California, and

John B. Milliken,

Bank of America Building,

Los Angeles, California

COUNSEL FOR DEFENDANT.

[Endorsed]: Conclusions of Law Proposed by deft.
Filed Sep. 5, 1936 R. S. Zimmerman, Clerk By Murray
E. Wire Deputy Clerk

[TITLE OF COURT AND CAUSE.]

PETITION FOR APPEAL

TO THE HONORABLE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF CALIFORNIA, CENTRAL DIVISION, AND TO HONORABLE WILLIAM P. JAMES, JUDGE THEREOF:

Your petitioner, DOUGLAS FAIRBANKS, the defendant in the above entitled cause, feeling himself aggrieved by the judgment rendered herein in favor of the plaintiff and entered on the 5th day of October, 1936, prays that an appeal may be allowed from said judgment to the United States Circuit Court of Appeals for the Ninth Circuit for the reasons specified in the Assignment of Errors, concurrently filed herewith, in order that the errors complained of may be corrected, and petitioner further prays that a citation be issued as provided by law commanding the plaintiff to appear before said Circuit Court of Appeals and that a transcript of the record, proceedings and papers in this cause, duly authenticated, may be sent to said Circuit Court of Appeals, and that an order be made fixing the amount of the cost bond which defendant shall give and furnish upon said appeal. Petitioner respectfully petitions that all proceedings in the said District Court of the United States be staid by superseas superseding this Honorable Court's judgment aforesaid.

That petitioner herein tenders bond in such amount as this Honorable Court may order for the purposes of this appeal.

Dated this 2nd day of December, 1936.

Dennis F. O'Brien

Dennis F. O'Brien

Arthur F. Driscoll

Arthur F. Driscoll

Paul Vallee

Paul Vallee

Citizens Bank Building

Los Angeles, California.

John B. Milliken

John B. Milliken

Bank of America Building

Los Angeles, California

Attorneys for Defendant.

SERVICE of true copy of the within instrument was duly admitted this 2nd day of December, 1936.

Peirson M. Hall

Peirson M. Hall

United States Attorney.

E. H. Mitchell

E. H. Mitchell

Special Assistant U. S. Attorney

Alva C. Baird

Alva C. Baird

Asst. United States Attorney

Attorneys for Plaintiff

[Endorsed]: Filed Dec. 3, 1936 R. S. Zimmerman,
Clerk By L. B. Figg, Deputy Clerk

IN THE DISTRICT COURT OF THE UNITED
STATES IN AND FOR THE SOUTHERN
DISTRICT OF CALIFORNIA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)	
)	
Plaintiff,)	
)	No. 6680-J
vs.)	
)	ASSIGNMENT
DOUGLAS FAIRBANKS,)	OF ERRORS
)	
Defendant.)	
)	

Comes now the defendant and appellant, DOUGLAS FAIRBANKS, and makes and files the following assignment of errors upon which he will rely in the prosecution of the appeal herewith petitioned for in said cause from the judgment of this Court entered on the 5th day of October, 1936.

I

The Court erred in rendering and entering its decision and judgment in favor of plaintiff and against the defendant for the reason that said decision and judgment is contrary to the law and is not supported by the facts as found by the Court.

II

The Court erred in denying defendant's motion, both oral and written, for judgment for the reason that upon

the facts as found by the Court, the defendant is entitled to recover judgment as a matter of law.

III

The Court erred in concluding as a matter of law from the facts found by the Court that the redemption by The Elton Corporation in the years 1927, 1928 and 1929 respectively, of its bonds held and owned by the defendant was not an exchange or sale of capital assets within the meaning of section 208 of the Revenue Act of 1926 and/or section 101 of the Revenue Act of 1928.

IV

The Court erred in concluding as a matter of law from the facts found by the Court that the amounts refunded to the defendant by the United States of America as over-payments of income taxes for the years 1927, 1928, and 1929, were erroneously made and that the plaintiff was entitled to recover the full amount sued for herein of \$72,186.94, or any other sum, together with interest.

V

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the surrender by the defendant of the said bonds of The Elton Corporation for redemption during the year 1927 was an exchange or sale of capital assets within the meaning of section 208 of the Revenue Act of 1926, for the reason that such conclusion of law is supported by the facts found by the Court.

VI

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the excess of the sum received by defendant during the

year 1927 upon the redemption of said bonds over and above the cost basis to defendant of the bonds surrendered was capital gain within the meaning of section 208 of the Revenue Act of 1926, and that said gain was taxable to defendant at the rates and in the manner provided in said section for the reason that such conclusion of law is supported by the facts found by the Court.

VII

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the defendant overpaid his income taxes for the year 1927 in the total amount refunded to defendant by the Commissioner of Internal Revenue and that all such sums so refunded to the defendant as overpayment of income taxes for the year 1927, and interest thereon, were correctly and legally refunded for the reason that such conclusion of law is supported by the facts as found by the Court.

VIII

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the United States of America is not entitled to recover from defendant any of the sums refunded to defendant as overpayments of income taxes for the year 1927 or any interest thereon, for the reason that such conclusion of law is supported by the facts as found by the Court.

IX

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the surrender by the defendant of the said bonds by The Elton Corporation for redemption during the year 1928 was an exchange or sale of capital assets within the meaning of section 101 of the Revenue Act of 1928, for the

reason that such conclusion of law is supported by the facts found by the Court.

X

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the excess of the sum received by defendant during the year 1928 upon the redemption of said bonds over and above the cost basis to defendant of the bonds surrendered was capital gain within the meaning of section 101 of the Revenue Act of 1928, and that said gain was taxable to defendant at the rates and in the manner provided in said section, for the reason that such conclusion of law is supported by the facts found by the Court.

XI

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the defendant overpaid his income taxes for the year 1928 in the total amount refunded to defendant by the Commissioner of Internal Revenue and that all such sums so refunded to the defendant as overpayments of income taxes for the year 1928, and interest thereon, were correctly and legally refunded for the reason that such conclusion of law is supported by the facts as found by the Court.

XII

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the United States of America is not entitled to recover from defendant any of the sums refunded to defendant as overpayment of income taxes for the year 1928 and any interest thereon, for the reason that such conclusion of law is supported by the facts as found by the Court.

XIII

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the surrender by the defendant of the said bonds of The Elton Corporation for redemption during the year 1929 was an exchange or sale of capital assets within the meaning of section 101 of the Revenue Act of 1928, for the reason that such conclusion of law is supported by the facts found by the Court.

XIV

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the excess of the sums received by defendant during the year 1929 upon the redemption of said bonds over and above the cost basis to defendant of the bonds surrendered was capital gain within the meaning of section 101 of the Revenue Act of 1928, and that said gain was taxable to defendant at the rates and in the manner provided in said section, for the reason that such conclusion of law is supported by the facts found by the Court.

XV

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the defendant overpaid his income taxes for the year 1929 in the total amount refunded to defendant by the Commissioner of Internal Revenue and that all such sums so refunded to the defendant as overpayments of income taxes for the year 1929, and interest thereon, were correctly and legally refunded for the reason that such conclusion of law is supported by the facts as found by the Court.

XVI

The Court erred in failing and refusing to conclude as a matter of law from the facts found by the Court that the United States of America is not entitled to recover from defendant any of the sums refunded to defendant as overpayments of income taxes for the year 1929, or any interest thereon, for the reason that such conclusion of law is supported by the facts as found by the Court.

XVII

The Court erred in allowing any interest whatsoever to the United States of America on the judgment recovered by it herein for the reason that no interest is due thereon.

XVIII

The Court erred in fixing the rate of interest at the rate of seven per cent (7%) per annum on said judgment so recovered herein by the United States of America in the event it is determined that interest was properly allowable on said judgment.

XIX

The Court erred in failing and refusing to fix the rate of interest on the judgment recovered herein by the United States of America at the rate of six per cent (6%) per annum, in the event it is determined that interest was properly allowable thereon.

XX

The Court erred in failing and refusing to render and enter judgment in favor of defendant for the reason that upon the facts found by the Court the plaintiff is entitled to judgment as a matter of law.

XXI

The Court erred in finding and concluding that the plaintiff is entitled to judgment against the defendant for its costs.

WHEREFORE, defendant prays that said judgment may be reversed and that the Circuit Court of Appeals for the Ninth Circuit render a proper order and judgment on the record, and for such other and further relief as to the Court may seem just and proper in the premises.

Dated this 30 day of November, 1936.

Dennis F. O'Brien

Dennis F. O'Brien

Arthur F. Driscoll

Arthur F. Driscoll

Paul Vallee

Paul Vallee

Citizens Bank Building

Los Angeles, California.

John B. Milliken

John B. Milliken

Bank of America Building

Los Angeles, California.

Attorneys for Defendant.

SERVICE of true copy of the within instrument was duly admitted this 2nd day of December, 1936.

Peirson M. Hall

Peirson M. Hall

United States Attorney,

E. H. Mitchell

E. H. Mitchell

Special Assistant U. S. Attorney

Alva C. Baird

Alva C. Baird

Assistant United States

Attorney

Attorneys for Plaintiff.

[Endorsed]: Filed Dec. 3 - 1936 R. S. Zimmerman,
Clerk By L. B. Figg, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ORDER ALLOWING APPEAL AND FIXING
BOND.

IT IS HEREBY ORDERED that the appeal prayed for in the petition filed therefor be and the same is hereby allowed for the review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision and judgment of the above entitled court referred to in said petition.

IT IS FURTHER ORDERED AND DIRECTED that pending such appeal the said Judgment of October 5th, 1936, referred to in said Petition for Appeal, be wholly superseded and suspended and that the plaintiff, United States of America, be and hereby is restrained and enjoined from collecting or attempting to collect on or by reason of said Judgment or having or attempting to have a writ of execution issued on or by reason of said Judgment, pending the final determination of this matter on appeal.

IT IS FURTHER ORDERED AND DIRECTED that the defendant and appellant give a bond on appeal as security for costs, conditioned as required by law, in the sum of \$250-, and that defendant and appellant give a further bond on appeal in the sum of \$100000 to stay the said Judgment of October 5th, 1936, as herein provided, and that the said bond be expressly conditioned

that defendant and appellant will pay said Judgment and the interest thereon as therein provided in the event that said judgment is affirmed on appeal or otherwise becomes final.

Dated this 2 day of December, 1936.

Wm P. James
UNITED STATES DISTRICT JUDGE.

SERVICE of true copy of the within instrument was duly admitted this 2nd day of December, 1936.

Peirson M. Hall

Peirson M. Hall

United States Attorney

E. H. Mitchell

E. H. Mitchell

Special Assistant U. S. Attorney

Alva C. Baird

Alva C. Baird

Asst. United States Attorney

Attorneys for Plaintiff.

[Endorsed]: Filed / Dec. 3 - 1936 R. S. Zimmerman
Clerk By L. B. Figg Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

STIPULATION FOR COSTS ON APPEAL

DOUGLAS FAIRBANKS, Defendant in the above action, having filed, or being about to file a petition for appeal to the United States Circuit Court of Appeals for the Ninth Circuit, from the judgment filed and entered in this matter in this Court against the Defendant and in favor of the Plaintiff, on the 5th day of October, 1936.

NOW, THEREFORE, in consideration of the premises, the undersigned FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a corporation duly organized and existing under the laws of the State of Maryland, and duly authorized to transact a general surety business in the State of California, does hereby undertake and promise on the part of the Appellant, and does acknowledge itself justly bound in the sum of Two Hundred Fifty and No/100 - - Dollars (\$250.00) that it will pay all costs and damages which may be awarded against the Appellant on the said appeal, or on the dismissal thereof; and the undersigned Surety further consents that in case of default or contumacy on the part of the said Appellant, execution to the amount named in this stipulation may issue against the goods, chattels and lands of the undersigned.

IN WITNESS WHEREOF, the corporate seal and the name of the said Surety is hereto affixed and attested at Los Angeles, California, by its duly authorized officers, this 4th day of December, A. D., 1936.

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND

[Seal]

By W. H. Cantwell

W. H. Cantwell—Attorney in Fact.

Attest S. M. Smith

S. M. Smith—Agent

Examined and recommended for approval in accordance with Rule 28.

John B. Milliken
Attorney

Approved this 5 day of December, 1936.

Wm. P. James
District Judge.

STATE OF CALIFORNIA }
County of Los Angeles } ss.

On this 4th day of December, 1936, before me Theresa Fitzgibbons, a Notary Public, in and for the County and State aforesaid, duly commissioned and sworn, personally appeared W. H. Cantwell and S. M. Smith known to me to be the persons whose names are subscribed to the foregoing instrument as the Attorney-in-Fact and Agent respectively of the Fidelity and Deposit Company of Maryland, and acknowledged to me that they subscribed the name of Fidelity and Deposit Company of Maryland thereto as Principal and their own names as Attorney-in-Fact and Agent, respectively.

[Seal]

Theresa Fitzgibbons

Notary Public in and for the State of California, County of Los Angeles.

My Commission Expires May 3, 1938

[Endorsed]: Filed Dec. 5, 1936 R. S. Zimmerman,
Clerk By Edmund L. Smith, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

UNDERTAKING ON APPEAL AND TO STAY
EXECUTION

WHEREAS, DOUGLAS FAIRBANKS, Defendant in the above entitled action, has appealed to the United States Circuit Court of Appeals for the Ninth Circuit, from a judgment made and entered against Douglas Fairbanks, Defendant in said action, in the District Court of the United States in and for the Southern District of California, Central Division, in favor of the United States of America, Plaintiff in said action on the 5th day of October, 1936, for the sum of Seventy-two Thousand One Hundred Eighty Six and 94/100 - - Dollars (\$72,186.94), and interest from July 6th, 1933 to October 5th, 1936 amounting to Sixteen Thousand Four Hundred Twenty Two and 53/100 - - Dollars (\$16,422.53), and

WHEREAS, the Appellant is desirous of staying the execution of the said judgment so appealed from.

NOW, THEREFORE, in consideration of the premises, and of such appeal, the undersigned, FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a corporation duly organized and existing under the laws of the State of Maryland, and duly authorized to transact a general surety business in the State of California, does hereby undertake and promise on the part of the Appellant, and does acknowledge itself justly bound in the sum of One Hundred Thousand and No/100 - - Dollars \$(100,000.00), being the amount fixed by the United

States District Court for the Southern District of California, Central Division, in its order allowing appeal and supersedeas, that if the said judgment appealed from, or any part thereof, be affirmed, or the appeal be dismissed, the Appellant will pay to the Respondent the amount directed to be paid by the judgment or order, or the part of such amount as to which the same shall be affirmed, if affirmed only in part, and all damages and costs which may be awarded against the Appellant upon the appeal; and that if the Appellant does not make such payment within thirty (30) days after the filing of the remittitur from the Circuit Court of Appeals in the Court from which the appeal is taken, judgment may be entered in said action on motion of the Respondent (and without notice to the undersigned Surety) in its favor against the said Surety, for such amount, together with the interest that may be due thereon, and the damages and costs which may be awarded against the Appellant upon the appeal.

IN WITNESS WHEREOF the corporate seal and the name of the said Surety Company is hereto affixed and attested at Los Angeles, California, by its duly authorized officers, this 4th day of December, A. D. 1936.

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND

By W. M. Walker

[Seal]

W. M. Walker - Attorney in Fact

Attest S. M. Smith

S. M. Smith - Agent

STATE OF CALIFORNIA)
) ss:
 County of Los Angeles)

On this 4th day of December, 1936, before me Theresa Fitzgibbons, a Notary Public, in and for the County and State aforesaid, duly commissioned and sworn, personally appeared W. M. Walker and S. M. Smith known to me to be the persons whose names are subscribed to the foregoing instrument as the Attorney-in-Fact and Agent respectively of the Fidelity and Deposit Company of Maryland, and acknowledged to me that they subscribed the name of Fidelity and Deposit Company of Maryland thereto as Principal and their own names as Attorney-in-Fact and Agent, respectively.

[Seal]

Theresa Fitzgibbons

Notary Public in and for the State of California,
 County of Los Angeles

My Commission Expires May 3, 1938

Examined and recommended for approval in accordance with Rule 28.

John B. Milliken

Attorney

Approved this 5 day of December, 1936.

Wm. P. James

District Judge

[Endorsed]: Filed Dec. 5, 1936. R. S. Zimmerman,
 Clerk. By Edmund L. Smith, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

PETITION FOR CROSS-APPEAL

TO THE ABOVE-ENTITLED COURT AND TO
HONORABLE WM. P. JAMES, JUDGE THERE-
OF:

Your Petitioner, the Plaintiff in the above-entitled cause respectfully shows that Douglas Fairbanks, the defendant in the above-entitled cause has been allowed an appeal herein from the judgment entered herein October 5, 1936, in this cause, and your Petitioner also considers itself aggrieved by said judgment as entered herein, and therefore hereby prays for the allowance of a cross-appeal from the United States District Court for the Southern District of California to the United States Circuit Court of Appeals for the Ninth Circuit from said judgment, and in connection with this petition Petitioner hereby presents Assignment of Errors dated December 29, 1936.

Peirson M. Hall

PEIRSON M. HALL,

United States Attorney

E. H. Mitchell

E. H. MITCHELL,

Special Assistant United States Attorney.

Alva C. Baird

ALVA C. BAIRD,

Assistant United States Attorney,

Attorneys for Plaintiff.

[Endorsed]: Filed Dec. 29, 1936. R. S. Zimmerman,
Clerk By Edmund L. Smith Deputy Clerk.

IN THE DISTRICT COURT OF THE UNITED
STATES IN AND FOR THE SOUTHERN
DISTRICT OF CALIFORNIA
CENTRAL DIVISION

UNITED STATES OF AMERICA,)	
Plaintiff and Cross-Appellant,)	
-v-)	No. 6680-J
DOUGLAS FAIRBANKS,)	
Defendant and Cross-Appellee.)	

PLAINTIFF'S AND CROSS-APPELLANT'S
ASSIGNMENT OF ERRORS.

The Plaintiff and Cross-Appellant above named makes and files the following Assignment of Errors upon which it will rely in the prosecution of its cross-appeal from the judgment of this Court entered therein on the 5th day of October, 1936:

I

The Court erred in entering judgment allowing plaintiff and cross-appellant recovery of interest from July 6, 1933, the date of demand for the return of the amount erroneously refunded, in that the plaintiff, under the law and the evidence, is entitled to interest from January 26, 1932, the date of payment of the erroneous refund involved.

II

The Court erred in failing and refusing to enter judgment allowing plaintiff recovery of interest at the rate of six per cent per annum from January 26, 1932, the date of payment of the erroneous refund involved in that the plaintiff, under the law, the pleadings, and the evidence, is entitled to interest at the rate of six per cent per annum from that date.

III

The Court erred in failing and refusing to enter judgment allowing Plaintiff recovery of interest at the rate of six per cent per annum from January 26, 1932, the date of payment of the erroneous refund, as provided by the provisions of Section 803, Title VI, of the Revenue Act of 1936.

IV

The Court erred in not granting the Plaintiff's and Cross-Appellant's Motion made at the conclusion of the trial for judgment in its favor as prayed for in the Complaint for the reason that said Motion was supported by both the law and the evidence in the case.

WHEREFORE the Plaintiff and Cross-Appellant prays that said Judgment may be reversed and that the Circuit Court of Appeals for the Ninth Circuit render a proper Order and Judgment on the record, and prays for such other and further relief as to the Court may seem just and proper in the premise.

Dated: This 29th day of December, 1936.

Peirson M. Hall

PEIRSON M. HALL,

United States Attorney.

E. H. Mitchell

E. H. MITCHELL,

Special Assistant U. S. Attorney.

Alva C. Baird

A. C. BAIRD,

Assitant United States Attorney.

Assistant United States Attorney.

[Endorsed]: Filed Dec 29 1936 R. S. Zimmerman,
Clerk By Edmund L. Smith, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

ORDER ALLOWING CROSS-APPEAL

The Plaintiff herein, United States of America, having filed its petition for cross-appeal from the judgment entered herein, together with its assignment of errors herein.

IT IS HEREBY ORDERED that the cross appeal prayed for in said petition of Plaintiff in the above-entitled cause is allowed.

Dated December 29, 1936.

Wm. P. James.

WM. P. JAMES

[Endorsed]: Filed Dec. 29 - 1936 R. S. Zimmerman,
Clerk. By Edmund L. Smith, Deputy Clerk.

[TITLE OF COURT AND CAUSE.]

STIPULATION RE CONTENTS OF RECORD ON
APPEAL AND CROSS-APPEAL.

WHEREAS an appeal has been taken by each of the parties to above entitled action from the Judgment rendered therein:

Now therefore, pursuant to the provisions of Revised Statutes Sec. 1013 (28 U. S. C. A. 864), IT IS HEREBY STIPULATED AND AGREED by and between the plaintiff and the defendant, through their respective counsel undersigned, that the following documents and papers shall constitute the record upon defendant's appeal to the Circuit Court of Appeals for the Ninth Circuit and upon the plaintiff's cross-appeal to the same Appellate Court; and the Clerk of above Court is hereby requested to prepare one transcript of such record and transmit the same to the Clerk of said Circuit Court of Appeals for use upon both appeals, and include therein the following:

1. Bill of Complaint filed by plaintiff.
2. Amended Bill of Complaint filed by plaintiff.
3. Answer filed by defendant.
4. Motion for Judgment filed by defendant.
5. Decision made and entered in said cause by Judge William P. James on March 18, 1936.

6. Minutes of Judge James dated September 30, 1936.
7. Minutes entered on September 5, 1936.
8. Special Findings of Fact requested by defendant and found and adopted by the Court and filed in said cause as the Findings of Fact.
9. Conclusions of law requested by defendant and filed in said cause.
10. Judgment.
11. Defendant's Petition for Appeal, Order allowing Appeal and fixing bond, and Admission of Service thereof.
12. Cost Bond on Appeal.
13. Supersedeas Bond on Appeal.
14. Defendant's Assignment of Errors.
15. Citation on Appeal.
16. Receipt of Service of Citation on Appeal.
17. Citation on Cross-Appeal.
18. Petition for Cross-Appeal.
19. Assignment of Errors on Cross-Appeal.
20. Order Allowing Cross-Appeal.
21. Clerk's Certificate and this Stipulation.

It is further stipulated that the plaintiff-cross-appellant shall pay \$.....of the cost of printing such tran-

script and that the defendant-appellant shall pay the balance thereof.

Dated this 12th day of January, 1937.

Dennis F. O'Brien

Dennis F. O'Brien

Arthur F. Driscoll

Arthur F. Driscoll

Paul Vallee

Paul Vallee

Citizens Bk. Bldg.

Los Angeles, Calif.

John B. Milliken

John B. Milliken

Bk. of Amer. Bldg.

Los Angeles.

Attorneys for Defendant.

Peirson M. Hall

Peirson M. Hall

United States Attorney.

E. H. Mitchell

E. H. Mitchell

Asst. U. S. Attorney.

Alva C. Baird

Asst. U. S. Attorney.

Attorneys for Plaintiff.

[Endorsed]: Filed Jan. 15, 1937. R. S. Zimmerman, Clerk. By Edmund L. Smith, Deputy Clerk.

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, R. S. Zimmerman, clerk of the United States District Court for the Southern District of California, do hereby certify the foregoing volume containing 103 pages, numbered from 1 to 103 inclusive, to be the Transcript of Record on Appeal in the above-entitled cause, as printed by the appellant and cross-appellant and presented to me for comparison and certification, and that the same has been compared and corrected by me and contains a full, true and correct copy of the citation; citation on cross-appeal; complaint; amended complaint; answer; motion for judgment; opinion and order; order of September 5, 1936; special findings of fact; order of September 30, 1936; judgment; conclusions of law requested by the defendant; petition for appeal; assignment of errors; order allowing appeal, stipulation for costs on appeal filed by appellant, and undertaking on appeal filed by appellant; petition for cross-appeal; assignment of errors on cross-appeal and order allowing cross-appeal filed by appellee, and stipulation re contents of record on appeal and cross-appeal.

I do further certify that the amount paid for printing the foregoing record on appeal by the appellant is \$63.31 and the amount paid by the cross-appellant is \$58.56 and that said amount will be paid the printer by the cross-appellant herein and a receipted bill is herewith enclosed, also that the fees of the Clerk for comparing, correcting and

certifying the foregoing Record on Appeal amount to \$16.25 and that said amount has been paid me by the appellant herein.

In Testimony Whereof, I have hereunto set my hand and affixed the Seal of the District Court of the United States of America, in and for the Southern District of California, Central Division, this 20th day of January, in the year of Our Lord One Thousand Nine Hundred and Thirty-seven and of our Independence the One Hundred and Sixty-first.

[Seal]

R. S. ZIMMERMAN,

Clerk of the District Court of the
United States of America, in
and for the Southern District
of California.

By EDMUND L. SMITH,

Deputy.

[Endorsed]: Printed Transcript of Record. Filed
Jan. 26, 1937. Paul P. O'Brien, Clerk.

No. 8444

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

DOUGLAS FAIRBANKS,

Appellant and Cross-Appellee,

VS.

UNITED STATES OF AMERICA,

Appellee and Cross-Appellant.

**Upon Appeals from the District Court of the United
States for the Southern District of California,
Central Division.**

**PROCEEDINGS HAD IN THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.**



-

United States Circuit Court of Appeals
for the Ninth Circuit

No. 8444

DOUGLAS FAIRBANKS,

Appellant and Cross-Appellee,

vs.

UNITED STATES OF AMERICA,

Appellee and Cross-Appellant.

MOTION TO PRESENT QUESTION OF
JURISDICTION AND TO FILE SUPPLE-
MENTAL BRIEF IN SUPPORT THEREOF

Comes now counsel for the defendant and respectfully requests the right to present to the Court a manifest question of jurisdiction plainly appearing from the record in this cause and to submit a supplemental brief in support thereof. As cause therefor and in support thereof counsel for the defendant submits that this action was instituted and is maintained by the United States of America under and pursuant to Section 610(b) of the Revenue Act of 1928 (26 U. S. C. A. 1646; 45 Stat. 875; Allegation XIII of Complaint—R. 11) which provides:

“Sec. 610. Recovery of Amounts Erroneously Refunded.—

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be

considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later."

It will thus be observed from the aforesaid statute that suit may be brought in the name of the United States, thereby providing and conferring jurisdiction, and the suit must be begun before the expiration of two years after the making of the alleged erroneous refund.

The Commissioner of Internal Revenue approved the certificate of overassessment to the defendant with respect to the refund of taxes here at issue for the years 1927, 1928 and 1929 on January 6, 1932. (Special Finding of Fact XXXIV—R. 72).

The defendant received the checks of the Disbursing Clerk of the United States Treasury constituting the alleged erroneous refunds on January 26, 1932 (R. 72 and 73).

Complaint on behalf of the United States of America was filed in this cause on January 20, 1934 (R. 24) and amended complaint was filed on May 23, 1934 (R. 42).

Section 1104 of the Revenue Act of 1932 (26 U. S. C. A. 1670(3); 47 Stat. 287) provides as follows:

"Sec. 1104. Date of Allowance of Refund or Credit.—Where the Commissioner has (before or after the enactment of this Act) signed a schedule of overassessments in respect of any

internal revenue tax imposed by this Act or any prior revenue Act, the date on which he first signed such schedule (if after May 28, 1928) shall be considered as the date of allowance of refund or credit in respect of such tax."

Since Section 610(b) of the Revenue Act of 1928, *supra*, provided jurisdiction of suits of this nature to be brought in the name of the United States, and since Section 1104 of the Revenue Act of 1932, *supra*, provides that the date of the allowance of refund shall be the date when the Commissioner of Internal Revenue signs the certificate of overassessment, and since it clearly appears from the record (R. 72) that the certificate of overassessment was approved in the case at bar on January 6, 1932, and it clearly appears from the record that the complaint in the name of the United States was filed on January 20, 1934 (R. 24), it therefore is manifestly clear from the record that neither the court below nor this court has jurisdiction of this cause.

The Circuit Court of Appeals for the Third Circuit, in the case of *United States of America v. Robert K. Wurts*, decided July 13, 1937 (not yet reported in *Federal Reporter* but found at Paragraph 9431 of *Commerce Clearing House 1937 Service*) decided that a suit for the recovery of an alleged erroneous refund must be brought within two years from the date the certificate of overassessment was signed by the Commissioner of Internal Revenue and not within two years from the receipt of the refund check by the taxpayer.

Wherefore, it is respectfully moved that this Court decide and determine that it is without jurisdiction in this cause and that permission be granted counsel for defendant to file supplemental brief in support of this motion.

Respectfully submitted,

DENNIS F. O'BRIEN
ARTHUR F. DRISCOLL
PAUL VALLEE

Citizens Bank Building,
Los Angeles, California
JOHN B. MILLIKEN
Bank of America Building,
Los Angeles, California
Attorneys for Defendant

Dated: This 19th day of August, 1937.

[Endorsed]: Filed Aug. 20, 1937. Paul P.
O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF MOTION

Sirs:

Please Take Notice that upon the annexed affidavit of Paul Vallee, sworn to the 27th day of September, 1937, and upon the record on appeal now on file with this court, and upon all the proceedings had herein, and upon the supplemental brief which it is proposed to file herein, a copy of which is annexed hereto and made part hereof, we shall move this court at the opening thereof on the 29th day of

October, 1937, at 10:00 o'clock in the forenoon, or as soon thereafter as counsel can be heard, at the courtroom of the United States Circuit Court of Appeals for Ninth Circuit, Room 326, in the United States Court House and Postoffice Building, Seventh and Mission Streets, San Francisco, California, for the following relief:

(1) That Douglas Fairbanks, as appellant, be permitted to file with this court a supplemental brief, a copy of which is made part of these motion papers, and that the said supplemental brief and the questions raised therein be considered by this court on this appeal.

(2) That this court reverse the judgment entered herein in the District Court in favor of the United States of America and against the said Fairbanks, and order that the complaint herein be dismissed.

(3) That petitioner have such other and further relief as to the court may seem just and proper.

Dated: Los Angeles, California, September 27, 1937.

DENNIS F. O'BRIEN,
ARTHUR F. DRISCOLL,

152 West 42nd Street,
New York, N. Y.

PAUL VALLEE,

Citizens National Bank Building,
Los Angeles, California,

JOHN B. MILLIKEN,

Bank of America Building,
Los Angeles, California,

Attorneys for Douglas Fairbanks,
Appellant.

To:

PEIRSON M. HALL

United States Attorney,

E. H. MITCHELL

Special Assistant United States Attorney,

ALVA C. BAIRD

Assistant United States Attorney

Attorneys for United States of America.

[Title of Circuit Court of Appeals and Cause.]

AFFIDAVIT IN SUPPORT OF MOTION

State of California,

County of Los Angeles—ss.

Paul Vallee, being duly sworn, says:

I am an attorney and counsellor at law. I am of counsel to Douglas Fairbanks, appellant and cross-appellee herein, and I am personally familiar with all the proceedings had herein. I am making this affidavit rather than Douglas Fairbanks because many of the matters herein are known to him only as matters of hearsay, and for the further reason that he is at present absent from the country.

This appeal involves a judgment in favor of the Government and against the said Fairbanks in the sum of \$88,609.45 [R. 77].

The issue involved in the action below was whether or not the Government was entitled to recover back from the said Fairbanks as taxpayer certain refunds

that had been made by the Government to the said taxpayer.

The object of this motion is to obtain the permission of this court for the filing of a supplemental brief (a copy of which is attached hereto) which raises for the consideration of this court the question of whether or not this action was begun by the Government within the period of limitation of two years fixed by section 610 of the Revenue Act of 1928.

On the 6th day of January, 1932, the Commissioner of Internal Revenue approved the certificate of overassessment to the said Fairbanks, as taxpayer. [Special Finding of Fact, R. 72].

On the 26th of January, 1932, the Government made the refunds by checks of the Disbursing Clerk of the United States Treasury [R. 72 and 73].

On January 20, 1934, action on behalf of the United States of America was begun against the taxpayer [R. 24].

The aforesaid facts which appear from the record show that the action was begun within the period of limitation set by section 610 of the Revenue Act of 1928 if the two-year term fixed therein is construed to run from the payment of the checks, but that the action was not begun within the period of limitation if the two-year term in question is construed to run from the date of the approval of the certificate of overassessment.

It is conceded that a defense based upon the payment and that the question was not raised during the trial.

The Two-Year Limitation in Section 610 Is Not One That Need Be Pleaded by Defendant. The Limitation Is a Condition Upon the Right.

Atlantic Coast Line Railroad v. Burnette,
239 U. S. 199;

United States v. Trollinger, 81 Fed.(2d) 167;
Tutsch v. U. S. Director General of Railways,
52 Cal. 650;

Stern v. La Compagnie Generale Transatlantique, 110 Fed. 996.

But the question of the period of limitations was not overlooked.

At that time the only direct authority on the subject was the case of *Paulson v. United States*, 78 Fed.(2d) 97, a decision by the Circuit Court of Appeals of the Tenth Circuit as of June 14, 1935. The said decision held that the two-year period of limitation dated only from the return of the money to the taxpayer. Counsel for the defendant in this action accepted the *Paulson* case as law, and decided therefore not to press the question of limitations upon the trial.

Counsel for the defendant did state that he was not going to raise the question of limitations, but the position of the Government was not prejudiced in any way thereby. Counsel's statement came about during the cross-examination of one Clarence Ericksen, business manager for the defendant. The cross-examination was being conducted by Mr. Baird. It was as follows:

"By Mr. Baird:

Q. Mr. Ericksen, how long have you been

business manager for Mr. Fairbanks?

A. I have been associated with Mr. Fairbanks since the fall of 1920.

Q. That is, continuously?

A. Yes.

Q. Have you been handling Mr. Fairbanks' affairs during his absence in England and other points on the other side of the Atlantic during the period immediately prior to the time this action was filed?

A. Yes.

Q. This suit was filed on January 20, 1934, and was Mr. Fairbanks in California at that time?

A. No.

Q. Where was he residing at that time, do you know?

A. He had no permanent residence.

Q. Was he in the United States?

A. No; he was not.

Q. How long had he been absent from the United States prior to that date?

A. I think sometime in May. I believe he left prior to May, '33, I think it was.

Q. May of 1933?

A. I believe so.

Q. And then prior to May, 1933, had he been absent from the United States for some extended time?

Mr. Driscoll: We are not going to raise any question of limitations.

Mr. Baird: Very well.

Mr. Driscoll: We so stated to the Attorney General a long time ago."

However, since the trial of this action was had, the question of the construction to be placed upon the provisions of section 610 of the Revenue Act of 1928 has been passed upon by the Circuit Court of Appeals of the Third Circuit, which has held that the period of limitation begins to run from the date of the approval of the certificate of overassessment, and not from the date of the return of the checks as decided by the Circuit Court of Appeals of the Tenth Circuit.

U. S. v. Robert K. Wurts, decided July 13, 1937, (Paragraph 9431 of Commerce Clearing House, 1937 Service).

Therefore there has been a complete change in the interpretation of section 610 of the Revenue Act of 1928 since the trial of this action.

Our Courts, Including the Supreme Court of the United States, Have Repeatedly Taken Notice of Changes in the Law That Have Taken Place During the Pendency of Appeals.

In *Watts v. Unione Austriaca*, 248 U. S. 9 at 21, Justice Brandeis said:

"This court, in the exercise of its appellate jurisdiction, has power not only to correct error in the judgment entered below, but to make such disposition of the case as justice may at this time require."

Justice Brandeis then continues:

"And in determining what justice now requires, the court must consider the changes in fact and in law which have supervened since the decree was entered below. (Citing a great many cases)."

See also:

Butler v. Eaton, 141 U. S. 240;

Nemours v. Richmond Guano Co., 297 Fed. 580, C. C. A. 4;

American Sugar Refining Co. v. New Orleans, 119 Fed. 691;

Meccano v. Wanamaker, 253 U. S. 136.

There Is No Question of Fact Involved. As Pointed Out Above the Record on Appeal Definitely Sets Forth the Dates Involved.

The absence of defendant Fairbanks from the country part of the two years in question, would not extend the period of limitations nor toll the statute. There is no exception contained in the terms of the statute. Section 610 of the Revenue Act of 1928 reads:

"Sec. 610. Recovery of Amounts Erroneously Refunded.

(b) Any portion of an internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded (if such refund would not be considered as erroneous under Section 608) may be recovered by suit brought in the name of the

United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later."

The operation of a statute of limitations is not suspended or postponed by the absence or non-residence of the debtor, unless such an exception is part of the statute.

Kendall v. U. S., 107 U. S. 123;

Amy v. City of Watertown, 130 U. S. 320;

McIver v. Ragan, 2 Wheaton 25;

Bank of Alabama v. Dalton, 9 Howard 522.

The fact that the State of California may have placed in its Statute of Limitations exceptions based upon absence from the state or country or non-residence does not affect the situation. The suit at bar is based solely upon a federal statute, namely, the Internal Revenue Act of 1928. The construction that is sought is a construction of that statute, and not of any California law.

The Appellant Is Not Necessarily Precluded From Raising This Question at This Time Simply Because He Failed to Raise the Question in the Court Below Nor Because It Was Not Included in the Assignment of Errors.

A case directly in point is Dobbins v. Commissioner of Internal Revenue, 31 Fed.(2d) 935, decided by the Circuit Court of Appeals of the Third

Circuit. That case involved the Statute of Limitations. At page 937 the court said:

"But the defense of the Statute of Limitations was not raised before the Board of Tax Appeals until after argument had been made. Thereafter the petitioner made application to the Board to reopen the case so that he might raise this defense, but it refused to do so. However, we may consider and dispose of a case on a question not raised by the court below. *U. S. v. Florence E. Williams*, 49 S. Ct. 97, 73 L. Ed. _____ (decided January 2, 1929), Rule 11 of this court. Any liability which the petitioner might have had was extinguished before this suit was brought, and the judgment against him for the supposed liability is reversed."

The rules of this court provide that the court on its own motion may notice an error not assigned (Rule 11), a similar rule existing in the United States Supreme Court. In the case of *U. S. v. Pena*, 175 U. S. 500, where there were no assignments of error contained in the record, the Supreme Court took jurisdiction and disposed of the case upon the facts set forth in the record, predicating its decision upon an issue not raised in either the District Court or the Circuit Court of Appeals.

At page 502 the court said:

"A third proposition is that no assignment of errors is annexed to the transcript as required by sections 997 and 1012 of the revised Statutes. But this is not sufficient to compel a

dismissal of the appeal. Paragraph 4 of Rule 21 of this court provides that the court may at its option notice a plain error not assigned. *School District v. Hall*, 106 U. S. 428, 27 L. Ed. 237, 1 Sup. Ct. Rep. 417."

In the case of *U. S. v. Williams*, 278 U. S. 314, the court makes it clear that the case is being disposed of upon an issue not raised in the lower tribunal, for the court says:

"We do not find it necessary to determine whether this view or that of the District Court is correct, but dispose of the case upon a ground urged here by the Government, but apparently it is fair to say not suggested to either court below."

The object of the rule is patent and its purposes wholesome. It enables an appellate tribunal to dispose of a case as justice may dictate, and precludes the possibility of continuing an injustice brought about by an inadvertent omission. Such objective was clearly recognized by the Circuit Court of Appeals for the First Circuit in the case of *Gandia v. Porto Rico Fertilizer Co.*, 2 Fed.(2d) 641.

At page 644 the court said:

"But no assignment of error has in any one of the three cases before us (numbers 1594, 1604 and 1777) brought up this matter for review by this court. Clearly these suits against the Fertilizer Company are but steps towards final adjustment of the accounts between the former

partners. We refer to this unassigned error as to the money judgment, rendered in number 1604 against the Fertilizer Company, less the amount involved, but overlooked in the final adjustment of the partnership accounts."

If action was not begun within the two-year period stipulated, the Government has no cause of action.

In *Miller v. United States*, 57 Fed.(2d), 889, District Judge Inch (E. D. N. Y.) had before him a claim on a war risk policy. At page 890 he said:

"The action was not commenced within the period specified by the statute. This is not a question of laches which could be waived by counsel or overlooked by the court, but is in my opinion a jurisdictional defect, and renders this court without jurisdiction to decide the case."

Wherefore, deponent petitions this court that Douglas Fairbanks be granted the relief set forth in the notice of motion.

PAUL VALLEE

Sworn to before me this 27 day of September, 1937.

[Seal] ORAETTA G. EHLERS,

Notary Public in and for the County of Los Angeles,
State of California.

[Endorsed]: Filed Sept. 30, 1937.

[Title of Circuit Court of Appeals and Cause.]

**NOTICE OF MOTION AND MOTION FOR
WRIT OF CERTIORARI FOR DIMINU-
TION OF RECORD.**

Service of copy acknowledged this first day of
October, 1937.

JOHN B. MILLIKEN.

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF MOTION.

To Douglas Fairbanks, Appellant and Cross-Appellee, and to Dennis F. O'Brien, Arthur F. Driscoll, Paul Vallee, and John B. Milliken, his attorneys:

You and each of you will please take notice that the Appellee and Cross-Appellant will bring the Motion, a copy of which is hereinafter attached, on for hearing before the United States Circuit Court of Appeals at San Francisco at the hour of 10:00 a. m. on the 29th day of October, 1937.

HOMER S. CUMMINGS.

Attorney General.

BEN HARRISON,

United States Attorney.

E. H. MITCHELL,

Ass't U. S. Attorney.

ALVA C. BAIRD,

Ass't U. S. Attorney.

[Title of Circuit Court of Appeals and Cause.]

**MOTION FOR WRIT OF CERTIORARI FOR
DIMINUTION OF RECORD.**

Since the above proceeding was docketed in this Court, two motions, one in typewritten form, and the other printed, have been served upon the Appellee by counsel for the Appellant. By these motions the Appellant, for the first time in this litigation, attempts to raise an issue of the statute of limitations.

Now, Therefore, comes the Appellee and Cross-Appellant, through its counsel, and moves the Court for a Writ of Certiorari for Diminution of the Record, and asks leave to incorporate as a part of the record on appeal those portions of the Official Court Reporter's transcript wherein an oral waiver and stipulation was made in open Court during the course of the trial by the parties hereto, through their respective attorneys, wherein all contentions that the instant suit was not timely begun were expressly waived by the defendant (now the Appellant and Cross-Appellee), as more particularly appears from the portion of the Official Reporter's transcript, a duly certified and approved copy of which is hereinafter attached.

This waiver and stipulation is essential and pertinent to a proper consideration of the Motion of the Appellant and Cross-Appellee. It was not heretofore incorporated as a part of the record on appeal as it is not pertinent or material to a determination

of any of the errors assigned by the Appellant and upon which this appeal is predicated.

Respectfully submitted,
HOMER S. CUMMINGS,
 Attorney General.
BEN HARRISON,
 United States Attorney.
E. H. MITCHELL,
 Ass't U. S. Attorney.
ALVA C. BAIRD,
 Ass't U. S. Attorney.

Dated: October 1, 1937.

State of California,
 County of Los Angeles—ss.

Alva C. Baird, being first duly sworn, deposes and says: That he is a duly appointed and acting Assistant United States Attorney for the Southern District of California, and one of the attorneys for the Appellee and Cross-Appellant in the above-entitled action; that he has read the foregoing Motion and knows the contents thereof, and that the same is true of his own knowledge, except as to the matters which are therein stated upon his information or belief, and as to those matters that he believes it to be true.

ALVA C. BAIRD.

Subscribed and sworn to before me this 1st day of October, 1937.

[Seal]

R. S. ZIMMERMAN,
 Clerk U. S. District Court, Southern
 District of California.

By **EDMUND L. SMITH,**

Deputy.

It is hereby certified that the following excerpts of the Reporter's Transcript are true and correct and it is ordered that the same be filed.

WM P. JAMES,

Judge.

[Certified Copy]

In the District Court of the United States in and for the Southern District of California, Central Division.

No. 6680-J

DOUGLAS FAIRBANKS,

Appellant and Cross-Appellee,

v.

UNITED STATES OF AMERICA.

Appellee and Cross-Appellant.

STIPULATION.

It is Hereby Stipulated and Agreed by and between the parties hereto, through their respective counsel, that the following two pages, hereinafter attached, are excerpts from the Reporter's Transcript of proceedings in the trial of the above-entitled case in the District Court for the Southern Judicial District of California, and that the Re-

porter's Transcript correctly reports the testimony had in this cause.

Dated: September 30, 1937.

HOMER S. CUMMINGS,
Attorney General.

BEN HARRISON,
United States Attorney.

E. H. MITCHELL,
Ass't U. S. Attorney.

ALVA C. BAIRD,
Ass't U. S. Attorney.

Attorneys for Appellee and Cross-Appellant.

DENNIS F. O'BRIEN,

ARTHUR F. DRISCOLL,

PAUL VALLEE,

JOHN B. MILLIKEN,

Attorneys for Appellant and Cross-Appellee.

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT OF
PROCEEDINGS.

Los Angeles, California.

November 19, 1935.

Reported by: A. M. Randol.

Cross Examination

By Mr. Baird:

Q. Mr. Erickson, how long have you been business manager for Mr. Fairbanks?

A. I have been associated with Mr. Fairbanks since the fall of 1920.

Q. That is, continuously?

A. Yes.

Q. Have you been handling Mr. Fairbanks' affairs during his absence in England and other points on the other side of the Atlantic during the period immediately prior to the time this action was filed?

A. Yes.

Q. This suit was filed on January 20, 1934, and was Mr. Fairbanks in California at that time?

A. No.

Q. Where was he residing at that time, do you know?

A. He had no permanent residence.

Q. Was he in the United States?

A. No; he was not.

Q. How long had he been absent from the United States prior to that date?

A. I think sometime in May. I believe he left prior to May '33, I think it was.

Q. May of 1933?

A. I believe so.

Q. And then prior to May, 1933, had he been absent from the United States for some extended time?

Mr. Driscoll: We are not going to raise any question of limitations.

Mr. Baird: Very well.

Mr. Driscoll: We so stated to the Attorney General a long time ago.

[Endorsed]: Filed Oct. 1, 1937.

R S. ZIMMERMAN,

Clerk.

By EDMUND L. SMITH,

Deputy Clerk.

It is certified that the foregoing is a true and correct copy of Stipulation and Order filed in the above-entitled cause as the same appears from the original remaining on file in my office.

Witness my hand and the seal of the said Court this 1st day of October, 1937.

[Seal]

R. S. ZIMMERMAN,

Clerk.

By EDMUND L. SMITH,

Deputy Clerk.

[Endorsed]: Filed October 2, 1937. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals
for the Ninth Circuit

Excerpt from Proceedings of Friday, October 29,
1937.

Before: Garrecht, Mathews and Haney,
Circuit Judges.

[Title of Cause.]

ORDER GRANTING MOTIONS, AND
SUBMITTING CAUSE

Ordered motion of appellant Fairbanks for leave to file supplemental brief presented by Mr. Arthur F. Driscoll, counsel for said appellant, and motion granted.

Further ordered motion of United States for writ of certiorari for diminution of record presented by Mr. Joseph M. Jones, Special Assistant to the Attorney General, counsel for appellee and cross-appellant and submitted and motion granted.

Further ordered appeal and cross-appeal argued by Mr. Arthur F. Driscoll, counsel for Douglas Fairbanks, and by Mr. Joseph M. Jones, Special Assistant to the Attorney General, counsel for United States, and submitted to the court for consideration and decision.

United States Circuit Court of Appeals
for the Ninth Circuit

Excerpt from Proceedings of Saturday, April 2,
1938.

Before: Garrecht, Mathews and Haney,
Circuit Judges.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION
AND FILING AND RECORDING JUDG-
MENT.

By direction of the Court, ordered that the type-written opinion this day rendered by this court in the above cause be forthwith filed by the clerk, and that a judgment be filed and recorded in the minutes of this court in the above cause in accordance with the opinion rendered therein.

[Title of Circuit Court of Appeals and Cause.]

Upon Appeals from the District Court of the
United States for the Southern District of Cali-
fornia, Central Division.

OPINION

Before Garrecht, Mathews and Haney,
Circuit Judges.

Mathews, Circuit Judge:

The United States (hereafter called plaintiff)
brought this action against Douglas Fairbanks

(hereafter called defendant) to recover amounts aggregating \$72,186.94 claimed to have been erroneously refunded to defendant on account of alleged overpayments of income taxes for 1927, 1928 and 1929, with 6% interest from the date of refund, January 26, 1932. The case was tried by the court without a jury, trial by jury having been expressly waived. The court made and filed special findings of fact and thereupon entered judgment in favor of plaintiff for the principal sum claimed, with 7% interest from the date (July 6, 1933) on which payment had been demanded of defendant. Both parties have appealed, plaintiff claiming that interest should have been allowed from the date of refund, defendant claiming that judgment should have been entered in his favor.

The action was brought under § 610(b) of the Revenue Act of 1928, 45 Stat. 875, 26 U.S.C.A. § 1646(b), which provides: "Any portion of an internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded . . . may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund."

Section 1104 of the Revenue Act of 1932, 47 Stat. 287, 26 U.S.C.A. § 1670(a) (3), provides: "Where the Commissioner has (before or after June 6, 1932) signed a schedule of overassessments in respect of any internal revenue tax imposed by the Revenue Act of 1932, or any prior revenue Act, the

date on which he first signed such schedule (if after May 28, 1928) shall be considered as the date of allowance of refund or credit in respect of such tax."

In this case, the schedule of overassessment was signed by the Commissioner on January 6, 1932. The refund check was delivered to the taxpayer on January 26, 1932. This suit was begun on January 20, 1934, more than two years after the signing of the schedule, but less than two years after the delivery of the refund check. Defendant contends that the two-year period specified in § 610(b) begins to run upon allowance of the refund—that is to say, upon the signing of the schedule by the Commissioner—and that this action, therefore, was not commenced in time. There is no merit in this contention. The two-year period commences, not upon the allowance, but upon the actual making of the refund. *United States v. Wurts*,U.S....., decided March 14, 1938.¹ This action was in time.

The trial court's findings of fact are not challenged. Facts found were as follows:

Defendant in 1925 became the owner and registered holder of debenture bonds of the Elton Corporation of the par value of \$4,000,000, dated March 5, 1925, payable March 5, 1935. Each bond contained the following provision: "This debenture bond may be redeemed by the corporation at any

¹Reversing *United States v. Wurts* (C.C.A. 3), 91 F.(2d) 547, cited by defendant.

time at its face value plus interest earned and unpaid hereon upon thirty days' notice to the registered holder thereof." In 1927, 1928 and 1929, the corporation did so redeem bonds held by defendant, of the aggregate par value of \$1,900,000, and defendant realized therefrom a taxable gain.

The question now to be decided is whether the gain so realized by defendant was a "capital gain," within the meaning of § 208(a)(1) of the Revenue Act of 1926, 44 Stat. 19, and § 101(c)(1) of the Revenue Act of 1928, 45 Stat. 811. If so, it was taxable at the rate of $12\frac{1}{2}\%$.² If not, it was taxable at the higher (normal and surtax) rates³ applicable to other income of defendant for the taxable years in question.

By §§ 208(a)(1) and 101(c)(1) the term "capital gain" is defined as meaning "taxable gain from the sale or exchange of capital assets consummated after December 31, 1921." It is conceded that the bonds in question were capital assets, and that they were redeemed after December 31, 1921. The question is whether such redemption constituted a "sale or exchange" of the bonds, within the meaning of §§ 208(a)(1) and 101(c)(1).

We think not. Between the *redemption* of a bond

²Revenue Act of 1926, § 208(b), 44 Stat. 20; Revenue Act of 1928, § 101(b), 45 Stat. 811.

³Revenue Act of 1926, §§ 210(a), 211(a), 44 Stat. 21; Revenue Act of 1928, §§ 11, 12(a), 45 Stat. 795, 796.

and the *sale or exchange* thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according to its terms. It is in no wise a sale or exchange. *Watson v. Commissioner*, 27 B.T.A. 463, 465;⁴ *Braun v. Commissioner*, 29 B.T.A. 1161, 1177. [Italics are by the Court].

First of the revenue acts according special treatment to capital gains was that of 1921. The above quoted definition of "capital gain" is found in the 1921 and subsequent revenue acts to and including that of 1932. 42 Stat. 232, 43 Stat. 262, 44 Stat. 19, 45 Stat. 811, 47 Stat. 191. Defendant cites Report No. 350 of the House Ways and Means Committee and Report No. 275 of the Senate Finance Committee, accompanying the Revenue Bill of 1921, as indicating a purpose to include in this definition gains resulting from the redemption of capital assets. We find in these reports no indication of any such purpose. In *Burnet v. Harmel*, 287 U.S. 103, 106, cited by defendant, the court said:

"Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the

⁴Overruling *Werner v. Commissioner*, 15 B.T.A. 482, cited by defendant.

taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess. on the Revenue Bill of 1921, p. 10; see *Alexander v. King*, 46 F.(2d) 235."

Thus, it appears, the purpose of Congress in relieving the taxpayer from "excessive tax burdens from gains resulting from a conversion of capital investments" was "to remove the deterrent effect of those burdens on such conversions." Conversions on which those burdens had a deterrent effect were sales and exchanges. Such burdens had, and have, no deterrent effect on the redemption of bonds or other capital assets. This, doubtless, is the reason why, prior to 1934, gains resulting from such redemption were never included in the definition of "capital gain." Whatever the reason, such gains were not so included, and the definition should not, we think, be expanded by judicial construction.

When Congress determined, as it did in 1934, to treat as "capital gains" gains resulting from the retirement of bonds issued by a government or corporation, it had no difficulty in expressing its intent in clear and unambiguous language. Revenue Act of 1934, § 117(f), 48 Stat. 715. If such intent had existed prior to 1934, it could and, we think, would have found similar expression.

In awarding judgment for the principal sum claimed, the trial court did not err. It erred to the

prejudice of plaintiff in allowing interest from the date of demand only. It erred to the prejudice of defendant in allowing interest at 7%. Section 610(d) of the Revenue Act of 1928, as amended by § 805(a) of the Revenue Act of 1936, 49 Stat. 1744, provides: "Erroneous refunds recoverable by suit under this section shall bear interest at the rate of 6 per centum per annum from the date of the payment of the refund." In this case, therefore, 6% interest should have been allowed from January 26, 1932.

As to the principal sum awarded (\$72,186.94), the judgment is affirmed. As to interest, it is reversed and the case is remanded, with directions to enter judgment in plaintiff's favor for 6% interest on said principal sum from January 26, 1932.

[Endorsed]: Opinion. Filed Apr. 2, 1938. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals for the
Ninth Circuit.

No. 8444.

DOUGLAS FAIRBANKS,

Appellant & Cross-Appellee,

vs.

UNITED STATES OF AMERICA,

Appellee & Cross-Appellant.

JUDGMENT.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

This Cause came on to be heard on the Transcript of the Record from the District Court of the United States for the Southern District of California, Central Division and was duly submitted.

On Consideration Whereof, It is now here ordered and adjudged by this Court, that the judgment of the said District Court in this Cause, as to the principal sum awarded (\$72,186.94), be and hereby is affirmed, and as to interest be and hereby is reversed, and that this cause be and hereby is remanded to the said District Court with directions to enter judgment in plaintiff's favor for 6% interest on the said principal sum from January 26, 1932.

[Endoresd]: Filed and entered April 2, 1938.
Paul P. O'Brien, Clerk.

[Title of Circuit Court and Cause.]

ORDER STAYING ISSUANCE OF MANDATE

Upon application of Messrs. O'Brien, Driscoll & Raftery, counsel for the appellant & cross-appellee, and good cause therefor appearing, It Is Ordered that the issuance, under Rule 32, of the mandate of this Court in the above cause be, and hereby is stayed to and including June 4, 1938; and in the event the petition for a writ of certiorari to be made by the appellant & cross-appellee herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

FRANCIS A. GARRECHT

United States Circuit Judge.

Date: San Francisco, California, April 25, 1938.

[Endorsed]: Filed Apr. 25, 1938. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

**CERTIFICATE OF CLERK, U. S. CIR-
CUIT COURT OF APPEALS FOR THE
NINTH CIRCUIT, TO RECORD CERTI-
FIED UNDER RULE 38 OF THE RE-
VISED RULES OF THE SUPREME
COURT OF THE UNITED STATES.**

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing one hundred and forty (140) pages, numbered from and including 1 to and including 140, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the appellant, and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

Attest my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 3rd day of May A. D. 1938.

[Seal]

PAUL P. O'BRIEN,
Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed January 16, 1959

On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit

A motion for leave to file a petition for rehearing and petition for rehearing having been filed in this case;

Upon consideration thereof, it is ordered by this Court that the said motion for leave to file and petition for rehearing be, and the same are hereby, granted.

And it is further ordered that the order denying certiorari be, and the same is hereby, vacated; and that the petition for writ of certiorari herein be, and the same is hereby, granted.

And it is further ordered that the entry of judgment herein by the United States District Court for the Southern District of California, Central Division be, and it hereby is, stayed until further order of the Court.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(10049)

FILE COPY

FILED

MAY 28 1938

CHARLES ELMORE GROPLEY
CLERK

IN THE

Supreme Court of the United States

October Term, 1937.

No.

65

DOUGLAS FAIRBANKS,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

**PETITION AND BRIEF FOR WRIT OF CERTIORARI
TO THE CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT.**

ARTHUR F. DRISCOLL,
Counsel for Petitioner.



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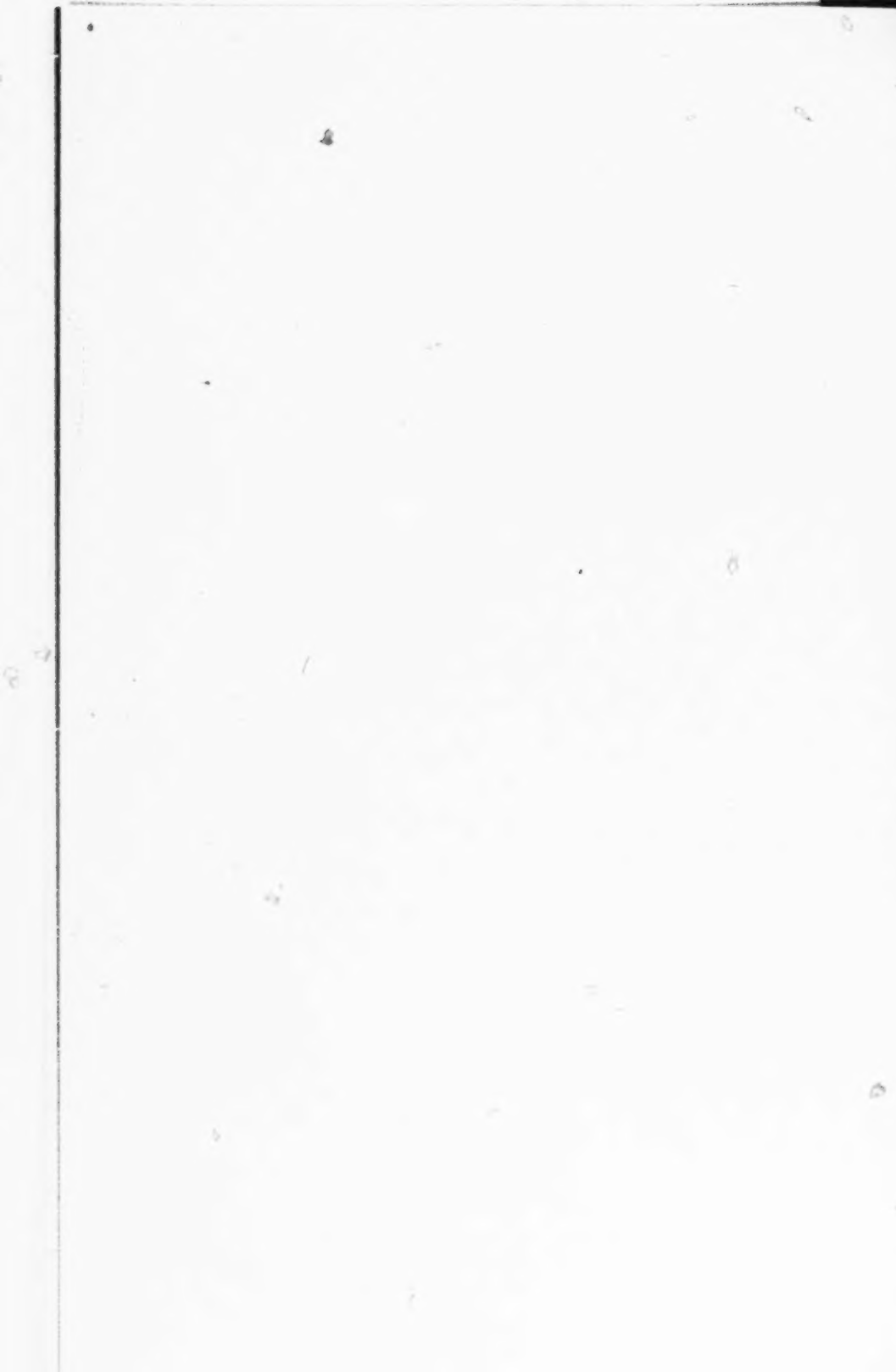
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IN THE
Supreme Court of the United States

OCTOBER TERM, 1937.

No.

DOUGLAS FAIRBANKS,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

**PETITION FOR A WRIT OF CERTIORARI TO THE
CIRCUIT COURT OF APPEALS FOR THE
NINTH CIRCUIT.**

*To the Honorable the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

Your petitioner, Douglas Fairbanks, respectfully prays for a writ of certiorari to the Circuit Court of Appeals for the Ninth Circuit, to review a judgment of that Court entered on April 2, 1938 (R. 139).

Opinions Below.

The opinion of the District Court is not officially reported, but is printed in full at Record pages 51 to 55. The opinion of the Circuit Court of Appeals is not as yet officially reported, but appears in full at Record pages 132 to 138.

Jurisdiction.

The date of judgment is April 2, 1938. Jurisdiction is invoked under Section 240-A of the Judicial Code, 28 U. S. C. A., Section 347.

Cases Believed to Sustain the Jurisdiction.

Burnet v. Harmel, 287 U. S. 103;

United States v. Kirby Lumber Co., 284 U. S. 1.

Statutes Involved.

Section 208(a)(1) of the Revenue Act of 1926 (44 Stat. 19) and Section 101(c)(1) of the Revenue Act of 1928 (45 Stat. 811) are printed in full in Appendix "A."

Questions Presented.

This case presents an important question of the law of Federal income taxation which has never been passed upon by this Court and, as is shown hereinafter, is a continuing source of litigation between taxpayers and the Bureau of Internal Revenue. The specific questions at issue are:

(1) Does the redemption before maturity of bonds by the issuing corporation constitute a *sale or exchange* for the purpose of income taxation as to the owner and holder of the bonds, within the meaning of Section 208(a)(1) of the Revenue Act of 1926 and Section 101(c)(1) of the Revenue Act of 1928.

(2) Does the gain realized by the bondholder from the redemption constitute

- (a) capital gain from the sale or exchange of a capital asset, taxable at the 12½% rate; or
- (b) ordinary income, taxable at both normal and sur-tax rates.

Summary Statement of the Matter Involved.

There is no issue of fact. All the facts are admitted by the pleadings, or have been stated as special findings of fact by the District Court.

The material facts are as follows:

Fairbanks is a citizen of the United States and a resident of California.

He has been engaged in the business of making motion pictures since the year 1916 (R. 59).

In the year 1925 Fairbanks was the owner of eight completed motion pictures and one in the process of making (R. 60).

Under date of March 5, 1925, Fairbanks made a contract with The Elton Corporation, under the terms of which he transferred to The Elton Corporation all his right, title and interest in the nine motion pictures aforementioned in exchange for \$4,000,000 par value debenture bonds, and 990 shares of no par value stock of said corporation, said bonds being ten-year bonds, dated March 5, 1925, and maturing March 5, 1935 (R. 60).

The debenture bonds received by Fairbanks contained the following provision:

"This debenture bond may be redeemed by the corporation at any time at its face value plus interest earned and unpaid hereon upon thirty days notice to registered holder hereof" (R. 60).

Fairbanks entered into a contract with The Elton Corporation at the same time, containing a provision that the corporation obligated itself to redeem \$100,000 face value of the bonds per year beginning three years after date of the contract; that is, after March 5, 1925 (R. 60).

The Elton Corporation did redeem and Fairbanks did surrender for redemption \$1,600,000 par value of said debenture bonds in 1927 (R. 60); \$150,000 par value in 1928 (R. 61) and \$150,000 par value in 1929 (R. 61).

Fairbanks duly filed his income tax returns for the years 1927 and 1928 and reported therein the sums received from the redemption of said debenture bonds (R. 62, 63). He took no deduction for cost, but reported the gross sum received as taxable (R. 62, 63). The amount received from the redemption of said bonds he reported as taxable at the capital gain rate of $12\frac{1}{2}\%$.

At the same time—that is, during the years 1927, 1928 and 1929—Fairbanks still had before the Commissioner of Internal Revenue a dispute as to taxes for the years 1917 to 1926, involving the question of whether or not the cost of motion pictures could properly be deducted in the year in which expended (R. 61, 64), as had theretofore been customary.

In December, 1929, a settlement was reached with the Commissioner of Internal Revenue as to said years. The settlement involved a recomputation of the taxes for those years on the basis of capitalizing the cost of pictures and amortizing said cost over a period of four years after the release of each picture—that is, 75% of the cost to be amortized in the first year, 15% in the second year, 5% in the third year, and 5% in the fourth year. Fairbanks, pursuant to said settlement, paid additional taxes and interest for the years 1917 to 1926 in the sum of \$695,840.53 (R. 64). Pursuant to the settlement and recomputation, it was determined that Fairbanks still had an unamortized cost of pictures of \$1,096,445.52 as of December 31, 1926 (R. 64) which he was entitled to deduct from his income for the following years in accordance with the aforesaid formula.

However, pending the settlement and before the unamortized cost had been fixed, Fairbanks had duly filed his Federal income tax return for the year 1929 and reported the amount received from the redemption of bonds of The Elton Corporation at the capital gain rate of $12\frac{1}{2}\%$. In that return he used as cost to be recouped, or the unamortized cost, the sum of \$928,630.87 and deducted a proportionate part of \$928,630.87, or the sum of \$34,823.65 (R. 65-66).

Under date of August 7, 1930, one L. E. Fellers, an Internal Revenue Agent, made his report of his audit of the Federal income tax returns filed by Fairbanks for the years 1927, 1928 and 1929, treating the proceeds in question as capital net gain, taxable at $12\frac{1}{2}\%$, and fixing the unamortized basic cost as of December 31, 1926, at \$1,096,445.52 (R. 66).

Following the report of Revenue Agent Fellers, Fairbanks filed with the Commissioner of Internal Revenue claims for refunds for the years 1927, 1928 and 1929, setting forth therein that he had not deducted from his income a proper cost for the bonds redeemed (R. 67-68).

Thereafter the Commissioner of Internal Revenue caused an audit to be made in connection with the claims for refund filed for the years 1927, 1928 and 1929 (R. 71). The Commissioner of Internal Revenue determined that Fairbanks was entitled to refunds for the years in question, and on January 26, 1932, did refund to Fairbanks for the year 1927 the sum of \$53,231.55, together with interest in the sum of \$9,795.05; for the year 1928, \$7,507.38, together with interest in the sum of \$932.40; for the year 1929, \$677.57, together with interest in the sum of \$42.99 (R. 72-73).

Thereafter the Commissioner of Internal Revenue determined that the refunds were erroneous and, through the Collector of Internal Revenue at Los Angeles, on July 6, 1933, officially demanded the return to the Government of the sums refunded (R. 73, 74).

No part of the sums refunded has been returned (R. 74).

Specification of Errors.

The errors which petitioner will urge if the writ of certiorari is granted are that the Circuit Court of Appeals for the Ninth Circuit erred:

1. In ruling that the redemption of its bonds by The Elton Corporation during 1927, 1928 and 1929 was not a "sale or exchange" of capital assets by Fairbanks within the meaning of the Revenue Acts of 1926 and 1928.

2. In ruling that Fairbanks must pay income tax on the gain from said redemption at normal and surtax rates instead of at the 12½% tax rate on capital gains as provided in the Revenue Acts of 1926 and 1928.

3. In ruling that the refunds made to Fairbanks on January 26, 1932, by the Commissioner of Internal Revenue were erroneous and that the United States was entitled to recover the amounts of said refunds with 6% interest thereon from the date of their payment.

4. In not ruling that Fairbanks had overpaid his Federal income taxes for the years 1927, 1928 and 1929.

Reasons for Granting the Writ.

Petitioner submits that the following reasons exist why this Court should grant a writ of certiorari:

1. *The Court below has decided an important question of Federal law which has not been, but should be, settled by this Court and in a way probably in conflict with applicable decisions of this Court on similar problems arising under the same provisions of the Revenue Act.*

It is conceded that The Elton Corporation bonds had been held by Fairbanks for over two years prior to their redemption and that they constituted "capital assets" as defined in the Revenue Acts of 1926 and 1928.

The sole question is, therefore, whether redemption of bonds before maturity constitutes a "sale or exchange" within the meaning of the Revenue Acts. This question has never been ruled upon by this Court and petitioner respectfully submits that such a ruling should be had for the reasons hereinafter set forth.

In 1921 Congress first legislated into the Revenue Act the remedial sections of these Acts known as the "Capital Gain and Loss" provisions, giving taxpayers the right to have such gains taxed at a flat rate of 12½% instead of at the extremely high normal and surtax rates.

7

The purpose of said legislation is found in Report No. 350 of the Ways and Means Committee of the 67th Congress, First Session, to accompany H. R. 8246, which is reprinted herein as Appendix "B."

This Court has given a similar clear statement of the reasons and problems causing the passage of the "Capital Gain and Loss provisions," in *Burnet v. Harmel*, 287 U. S. 103, where it is stated:

"Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on *gains resulting from a conversion of capital investments*, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess., on the Revenue Bill of 1921, p. 10; see *Alexander v. King*, (C. C. A. 10th), 74 A. L. R. 174, 46 Fed. (2d) 235." (Emphasis supplied.)

From the viewpoint of the bondholder, Fairbanks, the redemption of the bonds was the parting with capital assets—bonds—in exchange for money paid to him. It was a transfer of title for money. In 1925 he exchanged a capital asset—moving pictures—in return for a capital asset—bonds. In 1927, 1928 and 1929 he exchanged a capital asset—bonds—for money. Surely, Fairbanks has complied with the requirements stated by Mr. Justice Stone in *Burnet v. Harmel*, *supra*, in that he realized "gains resulting from a conversion of capital assets."

Fairbanks respectfully submits that the narrow construction placed upon the words "sale or exchange" by the Circuit Court of Appeals for the Ninth Circuit denies him the benefit of remedial legislation passed for the very purpose of protecting persons in his position and is in contravention of the expressed intent of Congress in so passing such legislation.

2. *The granting of a writ of certiorari will eliminate much litigation.*

Certainty in the principles and law of taxation is beneficial to both taxpayers and the Bureau of Internal Revenue. The present problem cries for an authoritative and final ruling, as the many changes in position on the present problem of both the Bureau of Internal Revenue and the Courts have been costly both to the Bureau and taxpayers and the source of much litigation between them.

A short historical resumé of this problem from an income tax standpoint reveals the following vacillating and contradictory constructions of the words "sale or exchange" by the Bureau of Internal Revenue and the Courts.

In 1923 the Commissioner ruled that the redemption of a bond at maturity could not be considered a "sale or exchange" of a capital asset, and the remedial 12½% tax rate did not apply (see I. T. 1637, II-1 C. B. 36, Appendix "C").

In 1929 the Board of Tax Appeals in *Henry P. Werner*, 15 B. T. A. 482 (acquiesced in by Commissioner), unanimously ruled otherwise.

The Commissioner thereupon revoked I. T. 1637 and promulgated I. T. 2488, VIII-2 C. B. 127 (Appendix "D"), and followed the *Werner* decision.

On July 27, 1930, the Board reaffirmed the *Werner* decision in *Alpin W. Cameron*, 20 B. T. A. 305, aff'd 56 Fed. (2d) 1021 (C. C. A. 3rd).

On December 29, 1932, the Board unanimously reversed *Henry P. Werner*, *supra*, in *John H. Watson, Jr.*, 27 B. T. A. 463 (acquiesced in by Commissioner), by holding that the redemption of a bond at or prior to maturity did not constitute a "sale or exchange." The Commissioner followed by revoking I. T. 2488, *supra*, and promulgated I. T. 2678, XII-1 C. B., 117 (see Appendix "E").

The next move in the checkered career of this problem was evolved by taxpayers more fortunate than Fairbanks whose bonds matured after the *Watson* decision. To obtain the benefits of the capital gains provisions denied them by

the *Watson* case, these taxpayers sold their bonds at the redemption or call price to friendly purchasers the day before the day stated in the call for redemption. Over the Commissioner's opposition the Board of Tax Appeals ruled that these transactions constituted a true "sale or exchange" and taxpayers so doing were not affected by the *Watson* decision, but could use the remedial $12\frac{1}{2}\%$ flat tax rate.

John D. McKee, Trustee, et al., 35 B. T. A. 239.

These shifting and conflicting decisions have resulted in a flood of litigation between taxpayers and the Bureau. A few of the cases and situations involved are as follows:

(a) *Bonds redeemed at or before maturity.*

Ernest W. Brown, 36 B. T. A. 178;

Wm. C. Rands, 34 B. T. A. 1107 (on appeal, C. C. A. 6th);

Felin v. Kyle, 22 Fed. Supp. 556.

(b) *Promissory notes settled after maturity.*

Hale v. Helvering, 85 Fed. (2d) 819.

(c) *Life insurance annuities surrendered.*

George A. Hellman, 33 B. T. A. 901.

The natural result of the uncertainty created by these conflicting decisions was the petitioning of Congress by taxpayers to ameliorate the confusing situation by clarifying the law (see Recommendations of Committee on Taxation of American Bar Association, reprinted in Appendix "F").

Congress took cognizance of the situation and in Section 117(f) of the Revenue Act of 1934 provided that the redemption of a bond at or prior to maturity constituted the exchange of a capital asset, thus specifically removing from further controversy the problem involved in the instant case.

Petitioner respectfully urges that Section 117(f) of the Revenue Act of 1934 was not new law as concerns the

redemption of bonds, but was more explicit explanation of the purpose of prior laws.

Helvering v. New York Trust Co., 292 U. S. 455;
Jordon v. Roche, 288 U. S. 446-455;
Merle-Smith v. Commissioner of Internal Revenue,
 42 Fed. (2d) 837-842;
McCauley v. Commissioner of Internal Revenue, 44
 Fed. (2d) 919-920.

Taxation being based on principles of equity, it seems inconceivable that Congress intended to benefit only taxpayers having bonds redeemed or maturing after January 1, 1934, to the exclusion of their less fortunate brethren whose bonds were called or matured prior to that date.

From the viewpoint of the Bureau and the Courts, parties to an identical transaction are treated in three different ways:

(a) Taxpayers like Fairbanks, who, relying on the *Werner* decision, were trapped by the *Watson* decision, are taxable on their gains at ordinary and surtax rates.

(b) Taxpayers having bonds maturing or redeemed after the *McKee* decision, *supra*, and taking advantage thereof, are taxable at the 12½% rate.

(c) Taxpayers with bonds maturing or redeemed after January 1, 1934, are taxable on their capital gains as provided in that Act.

Petitioner respectfully submits that this unfair and inequitable situation deserves an authoritative ruling from this Honorable Court.

WHEREFORE, it is respectfully submitted that this petition should be granted.

ARTHUR F. DRISCOLL,
 Counsel for Petitioner.

APPENDIX A.

Statutes Involved.

Section 208(a)(1) of the Revenue Act of 1926 (44 Stat. 19) and Section 101(c)(1) of the Revenue Act of 1928 (45 Stat. 811) are identical, providing:

“‘Capital gain’ means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.”

APPENDIX B.

Report No. 350, 67th Congress, First Session, to accompany H. R. 8245 (Revenue Act of 1921):

“CAPITAL GAINS AND LOSSES.

The sale of farms, mineral properties, and other capital assets is now seriously retarded by the fact that gains and profits earned over a series of years are under the present law taxed as a lump sum (and the amount of surtax greatly enhanced thereby) in the year in which the profit is realized. Many such sales, with their possible profit taking and consequent increase of the tax revenue, have been blocked by this feature of the present law. In order to permit such transactions to go forward without fear of a prohibitive tax, the proposed bill, in section 206, adds a new section (207) to the income tax, providing that where the net gain derived from the sale or other disposition of capital assets would, under the ordinary procedure, be subject to an income tax in excess of 15 per cent., the tax upon capital net gain shall be limited to that rate. It is believed that the passage of this provision would materially increase the revenue, not only because it would stimulate profit taking transactions, but because the limitation of 15 per cent. is also applied to capital losses. Under present conditions there are likely to be more losses than gains.”

APPENDIX C.

I. T. 1637, appearing at II-1 C. B. 36, provides:

"REVENUE ACT OF 1921.

Non-interest-bearing obligations of a political subdivision of a State were issued at 88 and upon maturity in the latter part of 1923 a taxable profit of 6 x will be realized by the holder not the original purchaser. Inasmuch as the obligations have been held for over two years inquiry is made whether the taxpayer will be subject to a tax on the capital net gain derived therefrom at the rate of 12½ per cent."

Section 206 of the Revenue Act of 1921 reads, in part, as follows:

"(a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

When an obligation matures it is neither sold nor exchanged. Any taxable profit derived upon maturity of a non-interest-bearing obligation is, therefore, not 'capital gain' derived from the sale or exchange of capital assets and section 206 does not apply."

APPENDIX D.

I. T. 2488, reported in VIII-2 C. B. 127, provides as follows:

"REVENUE ACTS OF 1921, 1924, 1926 AND 1928.

The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed as a capital net gain under the provisions of section 206 of the Revenue Act of 1921. I. T. 1637 (C. B. II-1, 36) revoked.

Likewise, any individual who has held stock in a corporation for more than two years and who derives a gain when the stock is 'called in' may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

The foregoing ruling is also applicable under the Revenue Acts of 1924, 1926 and 1928.

A ruling is requested as to the manner in which the gain from bonds or stock held for more than two years should be treated where the bonds are redeemed before their maturity date or the stock is 'called in.'

Under the provisions of section 206 of the Revenue Act of 1921, any taxpayer (other than a corporation) who for any taxable year derives a capital net gain may elect to be taxed on such capital net gain at the rate of 12½ per cent. in lieu of the tax he would otherwise pay on such income under sections 210 and 211. Section 206 of the Revenue Act of 1921 reads, in part, as follows:

(a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

In L. T. 1637 it was held that when an obligation matures it is neither sold nor exchanged. It was further held that any taxable profit derived upon maturity of an obligation is therefore not 'capital gain' derived from the sale or exchange of capital assets and section 206 does not apply.

Under date of February 19, 1929, the United States Board of Tax Appeals decided, in the case of Henry P. Werner (15 B. T. A. 482, see on page 56), that the redemption of bonds at a 'called' date for an amount in excess of the cost of the bonds to the bondholder results in a gain from the sale or exchange of capital assets within the meaning of section 206 of the Revenue Act of 1921. In the decision the legislative history of section 206 of the Revenue Act of 1921 was reviewed. It was stated that the Ways and Means Committee of the House and the Finance Committee of the Senate declared that the provision was intended

to be applicable to the 'sale or other disposition of capital assets.'

The ruling contained in I. T. 1637 is hereby revoked. The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed under the provisions of section 206 of the Revenue Act of 1921.

Likewise, any individual who has held stock in a corporation for more than two years and who derived a gain when the stock is 'called in' may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

As the provisions of the Revenue Acts of 1924, 1926 and 1928 relating to capital net gains are similar to the provisions of section 206(a)(1) of the Revenue Act of 1921, the foregoing ruling is also applicable under those Acts."

APPENDIX E.

I. T. 2678, appearing in XII-1 C. B. 117, is as follows:

"Revenue Acts of 1921, 1924, 1926 and 1928.

I. T. 2488 (C. B. VIII-2, 127), which holds that the gain derived from stock of a corporation 'called in,' or the gain derived from bonds as the result of their maturity or redemption before maturity, where such stock or bonds have been held for more than two years, may be taxed as a capital net gain, is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, Jr. v. Commissioner* (27 B. T. A. 463, page 13, this Bulletin)."

APPENDIX F.

Recommendations of Committee on Federal Taxation of American Bar Association, submitted to Ways and Means Committee of 73rd Congress, Second Session, in connection with the hearings on the Revenue Act of 1934:

"Section 101(c) of the 1932 act defines capital gains and losses as the gains or losses resulting from the 'sale or exchange' of capital assets. The United States Board of Tax Appeals has determined in *Henry P. Werner*, 15 B. T. A. 482, that included within the terms of 'sale or exchange' was the redemption by the obligor, at or before maturity, of a capital asset. Later the Board held, in *Watson*, 27 B. T. A. 463, that such redemption was not a 'sale or exchange.' Your committee believes that the Congress did not intend to remove from the benefits of the capital gains and loss provisions gains or losses from the redemption of capital assets, especially when such gains or losses, if the assets had been sold by the holder immediately before redemption, would be considered capital gains or losses.

Your committee recommends, therefore, the following resolution and amendment to Section 101(c) of the 1932 act:

'Be it resolved, that the American Bar Association recommends to the Congress that the Congress redefine the terms "capital gain" and "capital loss" to make clear whether such terms include gains and losses resulting from the redemption at maturity of capital assets, and that the Association's Committee on Federal Taxation is directed to urge the following proposed amendment and, failing the acceptance of the proposal as drafted, its equivalent in purpose, upon the proper committee of the Congress:'

(Proposed amendment.)

'That Section 101(c) (1) and (2) be amended to read as follows: "(C) Definitions.—For the purposes of this title—" (1) "Capital gain" means taxable gain from the *sale, exchange or redemption* of capital assets consummated after December 31, 1921.

'(2) "Capital loss" means taxable loss resulting from the *sale, exchange, or redemption* of capital assets.' "

The above appears in the printed record of the reports of the hearings of the Ways and Means Committee on the Revenue Act of 1934, and will also be found in the reports of the American Bar Association, Volume 58, page 455, 1933.



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IN THE
Supreme Court of the United States
OCTOBER TERM, 1938.

No. 65.

DOUGLAS FAIRBANKS,
Petitioner,

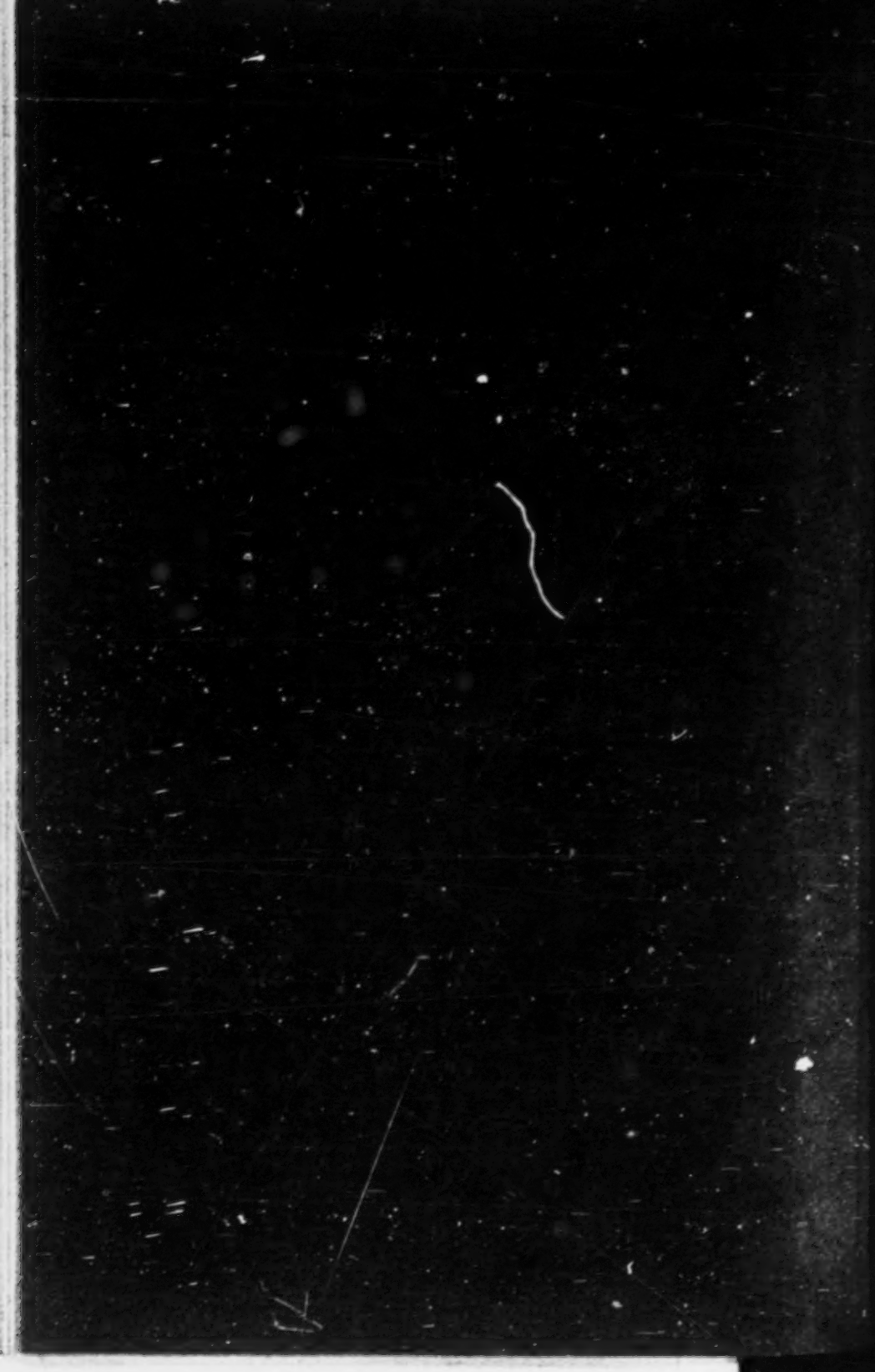
against

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Circuit Court of
Appeals for the Ninth Circuit.

BRIEF FOR PETITIONER

ARTHUR F. DRISCOLL,
Counsel for Petitioner.



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IN THE

Supreme Court of the United States

OCTOBER TERM, 1938.

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

No. 65

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE NINTH CIRCUIT.

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the District Court is not officially reported, but is printed in full at pages 51-55 of the Record.

The opinion of the United States Circuit Court of Appeals for the Ninth Circuit is reported in 95 F. (2d) 794 and appears at R. 132-138.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 2, 1938 (R. 139). A petition for writ of certiorari was denied by this Court on October 10, 1938 (83 L. Ed. 13).

A motion for leave to file a petition for rehearing was granted by this Court and the order denying certiorari was vacated and the petition for writ of certiorari granted on January 16, 1939 (83 L. Ed. 339).

The jurisdiction of this Court is invoked under the sections of 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (Chap. 229, 43 Stat. 938).

Questions Presented.

No question of fact was presented below. All facts are set forth in the pleadings and special findings (R. 59-74).

The specific questions at issue are:

(1) Does the redemption before maturity of bonds by the issuing corporation constitute a *sale or exchange of capital assets* within the meaning of Section 208(a)(1) of the Revenue Act of 1926, and Section 101(c)(1) of the Revenue Act of 1928? Or

(2) Is the gain realized by the bondholder from the redemption of bonds before maturity to be taxed at the 12½% rate or at normal and surtax rates?

Other questions considered by the Circuit Court of Appeals are not herein involved.

Statement of the Case.

The Bonds and Their Issue.

Prior to March 5, 1925, the taxpayer was the owner of eight finished and one unfinished motion pictures (F. V. R. 60). On that date he transferred the said pictures and all rights thereto, together with certain other property, to

(NOTE: The abbreviation "F." is used to indicate "Findings of Fact" and "R." to indicate "Record.")

The Elton Corporation, in exchange for \$4,000,000 face value debenture bonds of said corporation and 990 shares of its stock (F. VI, R. 60). The debentures matured March 5, 1935.

The debentures contained the following provision:

"This debenture bond may be redeemed by the corporation at any time at its face value plus interest earned and unpaid hereon upon thirty days' notice to registered holder hereof" (F. VII, R. 60).

At the same time the taxpayer entered into a contract with The Elton Corporation containing a provision under which the corporation obligated itself to redeem \$100,000 face value of the bonds per year beginning three years after date of the contract, that is, after March 5, 1925 (F. VII, R. 60).

Redemptions During 1927, 1928 and 1929.

The Elton Corporation redeemed, and the taxpayer surrendered for redemption, \$1,600,000 face value of the debentures in 1927 (F. VIII, R. 60), \$150,000 face value in 1928 (F. IX, R. 61), and \$150,000 face value in 1929 (F. X, R. 61).

Taxpayer Filed Returns for 1927, 1928 and 1929.

The taxpayer duly filed his income tax returns for the years 1927, 1928 and 1929, and reported therein the sums received from the redemption of said bonds. He paid a tax on the profits from the redemption of said bonds shown in said returns at the rate of $12\frac{1}{2}\%$ (Fs. XIV, XV and XVI, R. 62; Fs. XVII and XVIII, R. 63; Fs. XXII and XXIII, R. 65).

Controversy as to 1917-1926, Settled in 1929.

At the same time—that is, during the years 1927, 1928 and 1929—the taxpayer still had before the Commissioner of Internal Revenue a controversy as to taxes for the years 1917 to 1926, involving the question of whether or not the cost of

motion pictures could properly be deducted as expenses in the year in which expended, as had theretofore been customary (F. XVI, R. 62).

In December, 1929, a settlement was reached with the Commissioner of Internal Revenue as to taxes for the years 1917 to 1926 (F. XIX, R. 64). The settlement involved a recomputation of the taxes for those years, changing the method that had been used by the taxpayer whereby the taxpayer expensed the cost of the pictures in the year when made, to a basis of capitalizing the cost of pictures and amortizing the cost over a period of four years after the release of each picture; that is, 75% in the first year, 15% in the second year, 5% in the third year, and 5% in the fourth year (F. XX, R. 64).

The recomputation and amortization of the cost in accordance with the aforesaid formula required the taxpayer to pay, and the taxpayer did pay, additional taxes and interest for the years 1917 to 1926 in the sum of \$695,840.53 (F. XXI, R. 64).

Unamortized Cost as of End of 1926.

According to the aforesaid settlement and recomputation, it was determined that the taxpayer still had an unamortized cost of pictures as of December 31, 1926, of \$1,096,445.52, a proportionate part of which he was entitled to deduct from the proceeds of the bonds redeemed during each of the following years (F. XXI, R. 64).

The taxpayer had already filed his tax returns for 1927 and 1928, prior to the aforesaid settlement, reporting the entire proceeds of the bonds redeemed in those years as taxable, and deducting nothing for cost (F. XV, R. 62; F. XVIII, R. 63), and for 1929 (the return for which was filed after the settlement was arrived at, but before unamortized cost was definitely fixed), the taxpayer had deducted against the proceeds of the bonds a proportionate part of an estimated unamortized cost as of December 31, 1926, of \$928,630.87, instead of the official figure of \$1,096,445.52, later definitely fixed (F. XXII, R. 65).

On August 7, 1930, one L. E. Fellers, an Internal Revenue agent, made a report of his audit of the income tax returns filed by the taxpayer for the years 1927, 1928 and 1929, and officially fixed the unamortized basic cost of the bonds as of December 31, 1926, at \$1,096,445.52 (instead of the estimated \$928,630.87) and treated the profit received by the taxpayer from the redemption of said bonds during said years as capital net gain taxable at 12½% (Fs. XXIV and XXV, R. 66).

Following the report of Revenue Agent Fellers, the taxpayer filed with the Commissioner of Internal Revenue claims for refunds for the years 1927, 1928 and 1929, setting forth therein that he had not deducted from the proceeds of the bonds redeemed in the years 1927 and 1928 any part of the basic cost, and for 1929 had deducted a proportionate part of \$928,630.87 instead of the official figure of \$1,096,445.52 (Fs. XXVI-XXXII, R. 66-71).

The Commissioner of Internal Revenue recomputed the taxes on the profits made from the redemption of the said bonds, at the basic rate of 12½%, and determined that the taxpayer was entitled to refunds and he did refund to the taxpayer for the year 1927 the sum of \$53,231.55, together with interest in the sum of \$9,795.04; for the year 1928, \$7,507.38, together with interest in the sum of \$932.40; for the year 1929, \$677.57, together with interest in the sum of \$42.99 (Fs. XXXIII and XXXV, R. 71, 72).

Later, however, the Commissioner of Internal Revenue changed his ruling and determined that the refunds were erroneous, claiming the redemption of the bonds did *not* constitute the *sale or exchange of capital assets*, and therefore the profits were not taxable at the rate of 12½%, but were taxable at the higher (normal and surtax) rates applicable to other income of the taxpayer for the years in question, and he demanded the return to the Government of the sums refunded (F. XXXVI, R. 73). The taxpayer refused to return the refunds.

Action was begun therefor in the United States District Court for the Southern District of California, Central Division. After trial (jury waived), judgment was rendered in favor of the Government (Judgment, R. 76). The Circuit Court of Appeals affirmed that part of the judgment.

Specification of Errors.

Petitioner respectfully urges that the Circuit Court of Appeals for the Ninth Circuit erred:

1. In ruling that the redemption by The Elton Corporation of its bonds during 1927, 1928 and 1929 was not a "sale or exchange" of capital assets by taxpayer within the meaning of the Revenue Acts of 1926 and 1928.

2. In ruling that the taxpayer must pay income tax on the gain from said redemption at normal and surtax rates instead of at the $12\frac{1}{2}\%$ tax rate on capital gains as provided in the Revenue Acts of 1926 and 1928.

3. In ruling that the refunds made to the taxpayer on January 26, 1932, by the Commissioner of Internal Revenue were erroneous and that the United States was entitled to recover the amounts of said refunds with 6% interest thereon from the date of their payment.

4. In not ruling that the taxpayer had overpaid his Federal income taxes for the years 1927, 1928 and 1929.

Summary of Argument.

The redemption of bonds constitutes "sale or exchange" within the meaning of Section 208-a-1 of the Revenue Act of 1926 and Section 101-c-1 of the Revenue Act of 1928.

A. The statute involved and its requisites.

B. There have been shifting and conflicting decisions as to whether redemption of bonds comes within the term "sale or exchange."

C. It was *not* the intention of Congress to exclude redemption of bonds from the benefits of the capital gains section.

1. The meaning of the words "sale or exchange."
2. What is a redemption?
3. The exclusion of bond redemption from the benefits of the capital gains statute produces inequitable and absurd results.

D. The interpretation of the word "exchange" added to the capital gains section by Congress in 1934 constitutes a legislative declaration of its meaning and governs the construction of the capital gains provision from the time of its first enactment in 1921.

E. Conclusion.

1. The surrender by the taxpayer of bonds of the Elton Corporation for redemption during the years 1927, 1928 and 1929 was an exchange or sale of capital assets within the meaning of the provisions of the Revenue Acts of 1926 and 1928, and the excess of the sum received by the taxpayer over and above cost basis to the taxpayer was capital gain within the meaning of the Revenue Acts of 1926 and 1928 and was taxable to him at the flat rate of $12\frac{1}{2}\%$ instead of at the higher rates (normal and surtaxes).
2. The judgment of the Circuit Court of Appeals for the Ninth Circuit and the judgment of the District Court for the Southern District of California, Central Division, should be reversed and the complaint dismissed.

The Redemption of Bonds Constitutes "a Sale or Exchange" Within the Meaning of Section 208-a-1 of the Revenue Act of 1926, and Section 101-c-1 of the Revenue Act of 1928.

A.

The Statute Involved and Its Requisites.

Section 208-a-1 and a-8 of the Revenue Act of 1926 (44 Stat. 19) and Section 101-c-1 and c-8 of the Revenue Act of 1928 (45 Stat. 811) are identical, providing:

"'Capital Gains' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

'Capital Assets' means property held by the taxpayer for more than two years * * *."

Compliance must be had with three conditions:

- (1) It must be a capital asset.
- (2) Held for two years or more.
- (3) The gain must have resulted from a *sale or exchange*.

It is beyond dispute that (1) the bonds of The Elton Corporation constituted a capital asset and (2) had been held by the taxpayer for more than two years.

The sole question is whether the redemption of bonds (before maturity) constituted a "sale or exchange."

B.

There have been shifting and conflicting decisions as to whether redemption of bonds comes within the term "sale or exchange."

In IT 1637, II, 1 C. B. 36 (1923) (Appendix A), the Commissioner of Internal Revenue ruled that the payment of a non-interest bearing municipal bond at maturity did not constitute a "sale or exchange."

This ruling would seem to be limited to its own particular facts, for G. C. M. 1455, VI, 1 C. B. 87 (1927), holds that capital gain or loss is recognized on the sale or redemption of bonds, stating at page 89:

"The final position taken made no change in the rule as to original purchasers but reverted to the position first taken in so far as taxpayers who were not original purchasers were concerned. Thus, I. T. 1637 (C. B. II-1, 36) holds that where non-interest-bearing municipal bonds were issued at a discount, the profit realized upon payment at maturity by a holder who was not the original purchaser was taxable. The prevailing rule as to holders other than original purchasers—and that is the classification which includes the banks in the instant case—is that discount (and by analogy premium) is not to be treated as interest (or as an offset against interest in the case of premium) whether the bonds are sold or held to maturity. *The amount for which the bonds are purchased without regard to any discount or premium element therein is to be taken as the basis for determining gain or loss on their sale or redemption (O. D. 726, C. B. 3, 49), any profit realized being a profit resulting from the conversion of a capital asset and any loss sustained being deductible.*" (Italics ours.)

There seems to be no logical reason for a distinction between redemption *before* maturity and redemption *at* maturity. It is not clear that the Commissioner intended any.

In *Henry P. Werner*, 15 B. T. A. 482 (1929), the Board of Tax Appeals unanimously decided that the redemption of bonds *prior to maturity* did constitute a "sale or exchange." *The Commissioner acquiesced in this decision* and issued a new ruling revoking IT 1637, *supra*. The new ruling, IT 2488 VIII-2 C. B. 127 (1929) (Appendix B), definitely included both redemptions before maturity and redemption at maturity and ruled that such redemption did constitute "sale or exchange."

The Board followed the *Werner* decision in *Alpin W. Cameron*, 20 B. T. A. 305 (July 22, 1930), aff'd 56 F. (2d) 1021.

On December 29, 1932, the Board unanimously reversed itself in the case of *John H. Watson, Jr.*, 27 B. T. A. 463. The Board ruled that the redemption of a bond *at maturity* was *not* a "sale or exchange," and stated that the same ruling applied to the redemption of bonds *prior to maturity*, directly overruling the *Werner* decision. The Commissioner again acquiesced and followed by promulgating IT 2678 XII-1 C. B. 117 (1933) (Appendix C), which revoked IT 2488, *supra*, in so far as it applied to bonds.

The final steps in the conflicting interpretations of "sale or exchange" are the decision of the Ninth Circuit Court of Appeals presently being reviewed herein holding that the redemption of bonds is not a "sale or exchange" (Apr. 2, 1938), and the decision in *Frances M. Averill v. Commissioner* (Dec. 28, 1938) of the First Circuit Court of Appeals (Appendix D), holding that redemption of bonds is a "sale or exchange."

C.

It was *not* the intention of Congress to exclude a redemption of bonds from the benefits of the capital gains section.

First of the Revenue Acts according special treatment to capital gains was the Revenue Act of 1921, which permitted taxpayers to elect a flat tax of 12½% on gains from the "sale or exchange" of capital assets, in lieu of the normal and surtaxes formerly applicable.

When the Revenue Act of 1921 was being drafted, it was recognized that large amounts of revenue were lost by reason of the fact that taxpayers were reluctant to realize profits from capital investments because under the existing law such profits were allocable to the year of realization, and were thus subject to extremely high surtaxes. Such gains, unlike other income, might have accrued over several years, and the taxation of profits in the particular year in which they were realized, at a progressive rate, was imposing an undue and excessive tax burden. In order to give relief to the taxpayer and to permit such transactions to go forward, the Revenue Act of 1921 provided for the flat tax.

The Supreme Court has recognized these purposes of Congress in *Burnet v. Harmel*, 287 U. S. 103 (1932), where Mr. Justice Stone said, at page 106:

“ * * * The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted *to relieve the taxpayer from these excessive tax burdens on gains resultant from a conversion of capital investments and to remove the deterrent effect of those burdens on such conversions.*” (Italics ours.)

Mr. Justice Roberts in *Helvering v. New York Trust Co.*, 292 U. S., at page 470, speaks of “the paramount purpose to permit the payment of tax on capital gains at a reduced rate.”

“Capital assets” as defined by the capital gain and loss provisions of the Revenue Act are “property held and acquired by the taxpayer for *profit and investment* * * *.”

Corporate bonds and debentures are surely one of the most favored forms of capital investment, as financial history shows, and examinations of portfolios of banks, insurance companies and other professional investing companies disclose. Every bond has a maturity date and many are subject to redemption on call.

The *New York Times* of February 1, 1939, page 34, stated that bond redemptions before maturity *during January, 1939*, amounted to \$249,912,000. Surely Congress was cognizant of the nature of bonds and their common use as a medium of capital investment at the time of the insertion of the capital gain and loss provisions in the Revenue Act of 1921.

Having in mind that the purposes of the change were (a) to relieve the taxpayer from excessive tax burdens, and (b) thereby to remove a deterrent to the conversion of capital assets, and remembering that bonds are one of the most familiar forms of capital assets and investments, let us examine the words “sale or exchange” to determine if there is any good reason why a redemption of bonds should be excluded therefrom.

THE MEANING OF THE WORDS "SALE OR EXCHANGE."

"'Sale or exchange' is a transmutation of property from one man to another in consideration of some price or recompense in value."

2 Blackstone's Commentaries, p. 446.

Baltimore & Ohio Railroad Co. v. Western Union Telegraph Co., 241 Fed. 162-170, aff'd 242 Fed. 914 (1917).

The legislative history of the capital gain and loss provisions shows no intention on the part of Congress to narrow this definition.

The Ways and Means Committee of the House of Representatives in reporting the Revenue Act of 1921 (No. 350, Sixty-seventh Congress, First Session, to accompany H. R. 8245) said

"In order to permit such transactions to go forward without fear of a prohibitive tax, the proposed bill, in *Section 206*, adds a new section (207) to the income tax, providing that where the net gain from the *sale or other disposition of capital assets* would, under the ordinary procedure, be subjected to an income tax in excess of 15%, the tax upon the capital net gain shall be limited to that rate." (Italics ours.)

It is to be noted that the report uses the all-inclusive terms of "sale or other disposition."

The bill referred to by the House reads as follows:

"The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

* * * * *

The term 'capital assets' as used in this section includes property acquired and held by the taxpayer for *profit or investment* (whether or not connected with his trade or business) but does not include prop-

erty held for the personal use or consumption of the taxpayer or his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year." (Italics ours.)

The distinction there made was between transactions for profit and other transactions. It is apparent that there was no intention to further subdivide transactions for profit between voluntary transactions on the one hand and involuntary transactions on the other.

In Report No. 275 of the Senate Committee on Finance (Sixty-seventh Congress, First Session), to accompany H. R. 8245, the same bill, the Committee states:

"In order to permit such transactions to take place without fear of prohibitive tax, *Section 206* provides that only 40% of the net gain derived from the *sale or other disposition of capital assets* shall be taken into account in determining the net income upon which the income tax is imposed." (Italics ours.)

The Senate made no changes in the words "sale or exchange" contained in the House Bill.

It seems clear, beyond peradventure, that both the Senate and the House intended the words "sale or exchange" to mean any disposition of a capital asset held for profit or investment, by which title to the capital asset changed hands, for a valid consideration and on which gain or loss might be recognized. Congress sought words that would achieve that purpose and describe such transactions in contra-distinction to a gift, devise, bequest or other change of title needing special treatment. This is clearly brought out by reference to other sections of the Revenue Act of 1921. To describe transactions concerning capital assets on which gain or loss might be recognized Congress used the words "sale or exchange." But Congress in Section 202(a) uses the words "sale or other disposition." Why not in Section 206?

Section 202(a) of the Revenue Act of 1921 sets forth the basis for determining gain or loss *upon any transfer of property*. In this section Congress had to take cognizance of the fact that transfers of property take place both with and without consideration. Therefore, in enacting said section, Congress advisedly used the words "sale or other disposition" as it had in the 1913 and every succeeding Revenue Act.

Congress then goes on in further subdivisions of Section 202 to prescribe cost basis for property received by sale, exchange, gift, devise, bequest, reorganizations, condemnations, theft, seizure or destruction.

The conclusion seems irresistible that Congress, in enacting *the capital gains and loss provisions*, intended to include all transfers of title of capital assets held for profit and investment on which a gain or loss would be realized (sales or exchanges).

Yet the Board of Tax Appeals and the Ninth Circuit Court of Appeals excluded bond redemptions from the above all-inclusive words and intention.

As Circuit Court Judge Mathews, in his opinion in the instant case, states (R. 136) :

"Defendant cites Report No. 350 of the House Ways and Means Committee and Report No. 275 of the Senate Finance Committee, accompanying the Revenue Bill of 1921, as indicating a purpose to include in this definition gains resulting from the redemption of capital assets. We find in these reports no indication of any such purpose."

The learned Judge refuses to agree that the most logical explanation for the use of the terms "sale or exchange" was an intention to include all transactions where title to property was transferred in exchange for cash or other property and to exclude gifts and "other dispositions."

WHAT IS A REDEMPTION.

The word "redemption" has a meaning of general legal application, which is in no way limited by the Revenue Act.

In *Words and Phrases* (2nd Series), Vol. IV, page 220, the following is stated:

" 'To redeem' is defined as to purchase back; to regain property by paying a stipulated price; to regain property by paying what is due; to receive back by paying what is due; to receive back by paying the obligation * * * .

The word 'Redeem' does not mean to buy; it means to buy back; to liberate an estate by paying the debt for which it stood as security; to purchase in a literal sense."

In *Mannington v. Hocking Valley Ry. Co.*, 183 Fed. 133 (1910), the Court said:

" 'To redeem,' it is said in *Miller v. Ratterman*, supra, 'is to purchase back; to regain by paying what is due; to receive back by paying the obligation.' The word 'redeem,' as used in statutory provisions authorizing a party to redeem, means 'repurchase.' *Robinson v. Cropsey*, (N. Y.) 2 Edw. Ch. 138, 146; *Pace v. Bartles*, 47 N. J. Eq. (2 Dick.) 170, 20 Atl. 352."

The word "redeem" is similarly defined in Webster's International Dictionary, where the first definition given is as follows:

"To regain possession of by payment of a stipulated price; to repurchase."

See also:

Bunn v. Braswell, 142 N. C. 113, 116; 55 S. E. 85.

Miller v. Ratterman, 47 Ohio St. 141, 156; 24 N. W. 496.

Sicaringen v. Roberts, 12 Neb. 333, 335; 11 N. W. 325.

Pace v. Bartles, 47 N. J. Eq. 170, 174; 20 Atl. 352.

We can find no distinction drawn between redemption before maturity date and redemption at maturity date in so far as definition is concerned.

Redemption before maturity date is merely the very frequent expedient of accelerating the maturity, usually at the option of the issuing corporation.

Whether his bonds are called for redemption or sold in the open market, the bondholder is parting with a capital asset in exchange for money.

To attribute to Congress an intention to exclude redemption of bonds from the benefit of the capital gains provision is to disregard the plain meaning of the words "sale or exchange" and to produce absurd and inequitable differentiation between taxpayers similarly situated.

What is there concerning bond redemptions that should exclude them from the beneficial applications of the capital gains provision?

3.

THE EXCLUSION OF BOND REDEMPTION FROM THE BENEFITS OF THE CAPITAL GAIN STATUTE PRODUCES INEQUITABLE AND ABSURD RESULTS.

The bond market being subject to fluctuation, it seems apparent that on few bond redemptions will gain or loss not occur. To attribute to Congress an intent to exclude bond redemptions (at maturity or before maturity on call) from the benefits of the capital gain and loss section, while allowing such benefits where bonds are *purchased in the open market*, produces an absurd and inequitable result.

The unreasonableness and injustice of the exclusion of bond redemptions from the benefits of the capital gain section and the penalization effected thereby is clearly shown (a) by those cases that deal with the *redemption* of preferred stock and (b) sales of bonds held for more than two years even immediately before maturity of bonds, and (c) the treatment accorded gains on other "forced" sales.

a.

The Board of Tax Appeals ruled in *Mary S. Childs v. Commissioner*, 35 B. T. A. 1125 (1937), that the calling in of preferred stock by the issuing corporation constituted a "sale or exchange of capital assets."

See also:

Robert Meyer, 27 B. T. A. 44 (1932).

Louis Rorimer, 27 B. T. A. 871 (1932).

It is difficult to recognize either a real or practical distinction between the redemption of preferred stock and the redemption of bonds when each is the result of demand or notice by the corporation.

b.

The Board of Tax Appeals made a similar ruling in the case of *John D. McKee, Trustee, et al. v. Commissioner*, 35 B. T. A. 239 (1937). In that case the taxpayer had bonds which had been called for redemption at the American Trust Company on Monday, February 2, 1931. On Saturday, January 31, 1931, the taxpayer sought to *sell* the bonds to the corporate trustee at the office at which the bonds were payable. The trust officer informed the taxpayer that the corporate trustee had no right to purchase the bonds but referred him to the security affiliate of the trustee. Thereupon Mr. McKee detached the coupons and sold the bonds at par to the security affiliate of the corporate trustee, who in turn, on Monday, February 2, 1931, presented them to the corporate trustee and received payment in full.

It was specifically found as a fact that the only reason for the sale of the bonds by the taxpayer to the security affiliate was to place the transaction within the capital gains provisions thereby to avoid being taxed at a higher rate. The Board of Tax Appeals by unanimous decision held the transaction to be valid and the taxpayer to be entitled to the benefits of the capital gains section.

It seems unjust and inequitable that friendly sales could have been arranged by the taxpayer in the case at bar one day before the due date of the calls for redemption, with a difference in income taxes amounting to \$165,156.67.

c.

The revenue statutes do not deny a taxpayer the benefits of the capital gains provisions when a corporation is liquidated. A minority stockholder may very well have voted against a liquidation but have been forced to accept it. No distinction could legitimately be made for tax purposes between stockholders voting to dissolve and those objecting thereto.

And as shown *supra*, capital gain or loss must be computed by a preferred stockholder whose stock is redeemed upon call by the corporation.

Neither does the revenue law deprive a taxpayer of the benefit of the capital gains provisions where his property is taken by condemnation proceedings.

John J. Bliss, 27 B. T. A. 813 (1932).

IT 1378 I-1 C. B. 26 (1922).

Nor has the Board of Tax Appeals failed to give relief under the capital gains provisions of the statute where one dies possessed of installment obligations. The revenue laws provide that installment obligations shall be taken up as matured income at the date of the death of the owner.

Provident Trust Co., 29 B. T. A. 374.

The Bureau of Internal Revenue has ruled that a mortgagor whose property is foreclosed upon and sold pursuant to legal action taken by the mortgagee must compute his loss on the transaction under the capital gains and loss provisions.

G. C. M. 12737, XIII-1 C. B. 120 (1934).

The Circuit Court of Appeals in the instant case states (R. 135-136) :

“Between the *redemption* of a bond and the *sale or exchange* thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according to its terms. It is in nowise a sale or exchange. *Watson v. Commissioner*, 27 B. T. A. 463, 465; *Braun v. Commissioner*, 29 B. T. A. 1161, 1177.”

The reacquisition of bonds by an issuing corporation may be :

- (1) By redemption at maturity.
- (2) By redemption before maturity pursuant to the terms of the bond.
- (3) By purchase in the open market.

It is possible to draw metaphysical distinctions and to argue that in the first case the corporation is simply meeting its obligation when due, while in the second case it is likewise meeting its obligation but accelerating the due date, and in the third case the corporation is buying a piece of property without reference to its obligation to redeem. These distinctions might be of interest if the problem concerned a tax to be paid by the corporation.

But the bondholder occupies a different position. Whether the bondholder exchanges his bonds for cash on the due date or on a date prior to maturity, or sells his bonds in the open market, the result is the same—he has exchanged his bonds for cash—and the only distinction that can be made is that in the first two cases the exchange may be involuntary on the part of the bondholder, while in the third case it is a voluntary exchange.

When the learned Court says “such redemption is merely the payment of an obligation according to its terms,” it implies that because there is an obligation to pay the bond it cannot be an exchange. Or to state it differently—because the corporation is obliged to redeem its bonds and does in

fact force the bondholder to accept redemption prior to fixed due date, the bondholder on the other side of the transaction has not "exchanged" his asset. Surely there is nothing to indicate that Congress intended to limit the term "sale or exchange" to transactions where both sides are entirely free in their action.

The distinction made by the learned Court is not well founded. "Redemption" is distinguishable from "sale or exchange" but "sale or exchange" includes "redemption." Actually "redemption" is the exchange of bonds for cash. All redemptions are exchanges, but all exchanges are not redemptions. The fact that the redemption does or does not coincide with the maturity of the bond is not important. It still remains the exchange of a bond for cash.

To hold that in such case a redemption is not a "sale or exchange" is to hold an absurdity. It seems unquestionable that Congress would have specifically provided, *as it did in the 1934 and all subsequent Acts*, that "redemption" constituted an exchange, had it not seemed to be perfectly clear on its face. But as was said by this Court in *Burnet v. Guggenheim*, 288 U. S. 280, at 288:

"This is not to say that meaning has been lost because extraordinary foresight would have made it clearer."

In *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 79 L. Ed. 211 (1934), Mr. Justice Sutherland stated (at p. 218):

"The intention of the lawmaker controls in the construction of taxing acts as it does in the construction of other statutes, and that intention is to be ascertained, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with the context, the general purposes of the statute in which it is found, the occasion and circumstances of its use, and other appropriate tests for the ascertainment of the legislative will. Compare *Rein v. Lane*, L. R., 2 Q. B. 144, 151. The intention being thus disclosed, it is enough that the word or clause is reasonably susceptible of a

meaning consonant therewith, whatever might be its meaning in another and different connection." (*Italics ours.*)

This Court has consistently refused to penalize taxpayers by an overtechnical construction of words. In *Helvering v. New York Trust Co.*, 292 U. S. 455, the Commissioner attempted to distinguish (in Sec. 206-a-6 of the Revenue Act of 1921) the holding of property for two years by one taxpayer and the holding for a similar period by a taxpayer and his donee, contending that only in the first instance does the section apply. This Court rejected the distinction, holding it to be arbitrary and unreasonable, and declared at page 467:

"The legislative purpose to be served by the application of the lower rates upon capital gains is distinctly opposed to the Commissioner's construction. There is no ground for discrimination such as that to which the Trustee was subjected. It is to be inferred that Congress did not intend penalization of that sort."

In expounding its reasoning why such discrimination should not be allowed the Court recited the legislative history of the Act and, after pointing out the discrimination (*supra*), stated at page 464:

"But the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished.

* * * * *

Quite recently in *Ozawa v. United States*, 260 U. S. 178, 67 L. Ed. 199, 43 S. Ct. 65, we said (p. 194): "It is the duty of this Court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural significance, but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance

with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail.' "

See:

Aldridge v. Williams, 3 How. 9, 11 L. Ed. 469 (1845).

United States v. Factors Finance Co., 56 F. (2d) 902, aff'd 288 U. S. 89 (1933).

Hawaii v. Mankichi, 190 U. S. 197, 47 L. Ed. 1016 (1903).

The Ninth Circuit Court of Appeals in the case at bar, after quoting an excerpt from *Burnet v. Harmel*, 287 U. S. 103, 106 (R. 136-137), stated:

"Thus, it appears, the purpose of Congress in relieving the taxpayer from 'excessive tax burdens from gains resulting from a conversion of capital investments' was 'to remove the deterrent effect of those burdens on such conversions.' Conversions on which those burdens had a deterrent effect were sales and exchanges. Such burdens had, and have, no deterrent effect on the redemption of bonds or other capital assets."

The implication of the foregoing is that if the transaction was involuntary it should not benefit by the sale or exchange provision of the law since such transaction was not accelerated by the removal of the "deterrent effect" of an "excessive tax burden."

A reading of the opinion of this Court in *Burnet v. Harmel*, *supra*, demonstrates that this Court found Congress to have two purposes in mind, namely, first, to relieve the taxpayer from excessive tax burdens, and, second, to remove the deterrent effect of such excessive tax burdens on the sale or exchange of assets.

To attribute to Congress as its sole motive, gain in revenue without any relation to fairness to the taxpayer vitiates the entire intent of the legislation. If the only reason for enactment of the capital gain section was the increase in revenue there would have been no point whatsoever in limit-

ing the application of the statute to instances where the assets had been held for more than two years. Gains in revenue would result just as much by encouraging the sale of a capital asset which had been held only temporarily. The two years' limitation was specifically inserted because, as the Supreme Court says, it is inequitable to tax in one year a profit which in fact had accrued over a long series of years.

In *United States v. Hartwell*, 6 Wallace 385, at 396, the Court stated:

"The proper course in all cases is to adopt that sense of the words which best harmonizes with the context and promotes in the fullest manner the policy and objects of the legislature. The rule of strict construction is not violated by permitting the words of the statute to have their full meaning, or the more extended of two meanings, as the wider, popular instead of the more narrow technical sense; but the words should be taken in such a sense, bent neither one way nor the other, as will best manifest the legislative intent." (Italics ours.)

The doubt in the present and similar cases is not caused by the words themselves but by the breadth of the transactions they are intended to cover. In *Brewster v. Gage*, 280 U. S. 327, the question before this Court was when a residuary legatee "acquired" property devised for the purpose of capital gain or loss. This Court examined the legislative history of the Act and held that the legatee "acquired" legal title for tax purposes at the time of death, holding that the legislative history did not indicate a purpose to establish different bases for specific and general bequests and that it would be unreasonable to attribute to Congress an intent to have the estate calculate gains and losses on one basis and the residuary legatee calculate his on another.

So, in this case, we submit it is unreasonable to attribute to Congress an intent to differentiate for tax purposes between a man returning bonds to a corporation pursuant to a call for redemption and a man selling the bonds to the corporation without call.

In *Factors Finance Co. v. United States*, 56 F. (2d) 902, affirmed 288 U. S. 89 (1933), it was stated at page 908:

"Statutes must have a reasonable construction, and the language must be interpreted with reference to the subject-matter and the general course of business to which they relate, and in such manner that the beneficent provisions of remedial laws may not be thwarted by nice technicalities not within the minds of the legislators. *Lynch v. Alworth-Stephens Co.*, 267 U. S. 364, 370, 45 S. Ct. 274, 69 L. Ed. 660; *Old Colony R. Co. v. Commissioner of Internal Revenue*, 52 S. Ct. 211, 76 L. Ed. . . ., decided February 15, 1932."

D.

The interpretation of the word "exchange" added to the capital gains section by Congress in 1934 constitutes a legislative declaration of its meaning and governs the construction of the capital gains provision from the time of its first enactment in 1921.

The decision in *John H. Watson, Jr., supra*, holding that redemption of bonds did not come within the capital gain or loss provisions of the Revenue Act, was promulgated on December 29, 1932, and IT 2678, *supra*, was issued in January or February, 1933. In June, 1933, the Ways and Means Committee commenced the drafting of a new Revenue Act and ordered public hearings held for the purpose of obtaining advice as to changes and clarifications made necessary by decisions in the Income Tax Law.

Mr. George M. Morris, Chairman of the Committee on Federal Taxation of the American Bar Association, by oral argument and by a brief submitted to the Ways and Means Committee, pointed out the conflict between the *Werner* and *Watson* decisions, *supra*, and asked for clarification of the meaning of Congress. On pages 190 and 191 of a publication of the Government Printing Office entitled "Revenue Revision, 1934, Hearing Before the Committee on Ways and Means, House of Representatives, Seventy-Third Congress, Second Session, December 15 to 21, 1933, and January 9 to

11, 1934," appears the written recommendations of the American Bar Association, the portion of which applicable to the problem at the bar being as follows:

"5. Section 101 (c) of the 1932 act defines capital gains and losses as the gains or losses resulting from the 'sale or exchange' of capital assets. The United States Board of Tax Appeals has determined in *Henry P. Werner*, 15 B. T. A. 482, that included within the terms of 'sale or exchange,' was the redemption by the obligor, at or before maturity, of a capital asset. Later the Board held, in *Watson*, 27 B. T. A. 463, that such redemption was not a 'sale or exchange.' *Your committee believes that the Congress did not intend to remove from the benefits of the capital gains and loss provisions gains or losses from the redemption of capital assets, especially when such gains or losses, if the assets had been sold by the holder immediately before redemption, would be considered capital gains or losses.*" (Italics ours.)

"Your committee recommends, therefore, the following resolution and amendment to Section 101 (c) of the 1932 act:

"Be it resolved, that the American Bar Association recommends to the Congress that the Congress redefine the terms "capital gain" and "capital loss" to make clear whether such terms include gains and losses resulting from the redemption at maturity of capital assets, and that the Association's Committee on Federal Taxation is directed to urge the following proposed amendment and, failing the acceptance of the proposal as drafted, its equivalent in purpose, upon the proper committee of the Congress:

(Proposed Amendment.)

"That Section 101 (c) (1) and (2) be amended to read as follows: "(C) Definitions.—For the purposes of this title—" (1) "Capital gain" means taxable gain from the *sale, exchange or redemption* of capital assets consummated after December 31, 1921.

(2) "Capital loss" means taxable loss resulting from the *sale, exchange or redemption* of capital assets."

Section 117 of the Revenue Act of 1934 as enacted contains the following subsection, which puts an end to the controversy:

"f. Retirement of Bonds, etc.

For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

The intent of Congress is perfectly clear. It seems patent that the interpretive words in the statute were designed to accomplish exactly what your petitioner contends, namely, that Congress intended *not to change the law, but to clarify the meaning* in the prior Revenue Acts.

That the Ways and Means Committee and the Senate Finance Committee in their reports omit any reference to paragraph (f) of Section 117 strengthens our contention that the purpose was to clarify and not to amend. Both the Ways and Means Committee and the Senate Finance Committee discuss fully in their reports the drastic alterations made in the capital gains law in the Act of 1934, but do not mention Section 117(f). If either of these committees had thought this subsection was new legislation changing the law, proper parliamentary procedure would have required them to state in their reports the reason why they recommended such change.

In *Mead Corporation*, 38 B. T. A. #93, promulgated September 30, 1938, the Board of Tax Appeals, in discussing the significance of the omission of language in committee reports concerning the meaning of an amendment to Section 102 of the Act, stated at page 18:

"It has been suggested that the amendment included in the 1934 Act, which put the question we are considering beyond any possible doubt, is evidence that Congress believed a change to be necessary, and there-

fore that the section had meant something different previously. Without considering the effect of the decision by one Congress as to the meaning of legislation enacted by another, it is sufficient to say here that there is no evidence that the change in language so made was anything more than clarification, or that there was any intention to enact a new or different provision. Although the Ways and Means Committee Report 'pointed out' the application of the section to the 'shareholders of a parent corporation,' it referred to 'two important changes' it proposed, neither of which is the altered language significant here. The Senate Finance Committee Report contains no mention of this altered language which was added by the House, but states only that 'The House bill changes the existing law in two respects' (those discussed in the House Report) indicating that the Senate likewise did not view the language here in question as changing the existing law. There had been some question raised as to the meaning of the section, and under such circumstances a desire for clarification is easily conceivable. We are not required thereby to assume that any change of the previous law was intended. 'Mere change of language does not necessarily indicate intention to change the law. The purpose of the variation may be to clarify what was doubtful and so to safeguard against misapprehension as to existing law.' *Helvering v. New York Trust Co., supra.*" (Italics ours.)

It is noteworthy that the words "sale or exchange" were retained and the meaning of "exchange" explained in a subsection. Had Congress intended to change the law, it is submitted that the change would have been made by adding the word "redemption" or some similar word to the words "sale or exchange."

It being the intention of Congress to interpret rather than to amend, the rule laid down by Chief Justice Marshall in *Alexander v. The Mayor, &c. of Alexandria*, 5 Cranch. 1 (1809), applies. By virtue of this opinion it has become a settled law of statutory construction that when doubt arises as to a meaning of a statute and the Legislature which enacted the same, by subsequent re-enactment, adds words by way of explanation or amplification of the disputed phrase, such additional words are deemed to evidence the intent of

the legislative body in passing the original act. As Chief Justice Marshall stated:

"Without deciding this question as depending merely on the original law, it is to be observed that acts *in pari materia* are to be construed together as forming one act. If in a subsequent clause of the same act provisions are introduced which show the sense in which the legislature employed doubtful phrases previously used, that sense is to be adopted in construing those phrases. Consequently, if a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language, the rule which has been stated, requiring that the subsequent should be incorporated into the foregoing act, is a direction to courts in expounding the provisions of the law."

The rule is again succinctly stated in 25 Ruling Case Law, 1064, at Section 288, which reads:

"If in a subsequent clause of the same act provisions are introduced which show the sense in which the legislature employed doubtful phrases previously used, that sense is to be adopted in construing those phrases. Consequently, *if a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language, the rule which has been stated, requiring that the subsequent should be incorporated into the foregoing act, is a direction to courts in expounding the provisions of the law.* An amendment to an act may be resorted to for the discovery of the legislative intention in the enactment amended." (Italics ours.)

See also:

Panther Rubber Co. v. Commissioner, 45 Fed. (2d) 314 (1930).

Old Colony Trust Co. v. Malley, 19 Fed. (2d) 346; cert. denied 275 U. S. 563 (1927).

Joy Floral Co. v. Commissioner, 29 Fed. (2d) 865 (1928).

Merle-Smith v. Commissioner, 42 Fed. (2d) 837 (1930).

McCauley v. Commissioner, 44 Fed. (2d) 919 (1930).

Greensboro Gas Co., 30 B. T. A. 1361, aff'd 79 Fed. (2d) 701 (1935).

Davidson Grocery Co. v. Lucas, 37 Fed. (2d) 806 (1930).

Johnston v. Commissioner, 86 Fed. (2d) 732; cert. denied 301 U. S. 683 (1937).

W. A. Sheaffer Pen Co. v. Lucas, 41 Fed. (2d) 117 (1930).

Jordan v. Roche, 228 U. S. 436, 57 L. Ed. 908 (1913).

Helvering v. New York Trust Co., *supra*.

Jordan v. Roche, *supra*, and *Helvering v. New York Trust Co.*, *supra*, clearly demonstrate the readiness of this Court to construe a subsequent addition as a clarification of existing law, when, as in this case, it is clear that Congress intended to correct inequitable and absurd results occasioned by judicial construction.

In *Jordan v. Roche*, this Court had for decision the question of whether or not bay rum imported from Porto Rico during 1907 and 1908 was subject to tax under the Foraker Act of 1900 (Chap. 191, 31 Stat. 77) which taxed the importation of "distilled spirit, spirits, alcohol and alcohol spirit." The plaintiffs contended that the amendment of the Act in 1909 to raise the tax specifically on bay rum imported from Porto Rico indicated that bay rum was not taxed by the prior Act. The Court denied this conclusion and held that bay rum was taxed by the Foraker Act, stating:

"One other contention of plaintiffs we may notice. On February 4, 1909, 35 Stat. 594, c. 65, Congress passed the act by which it is provided 'that upon bay rum, or any article containing alcohol, hereafter brought from Port Rico into the United States for consumption or sale there shall be paid a tax on the spirits contained therein of one dollar and ten cents per proof gallon,' and the Commissioner of Internal Revenue is given power to establish rules to make the act effective. It is insisted that this act is a declaration by Congress that bay rum was not subject to a tax under prior statutes. The history of the act rejects the contention and manifests that the act was passed in consequence

of the decision in *Neichall v. Anderson*, and the other decisions to which we have referred. *The law was not the declaration of a new policy but a more explicit expression of the purpose of the prior law, made necessary by the judicial construction of that law.*" (Italics ours.)

Helvering v. New York Trust Co., *supra*, is a particularly strong authority for the interpretation claimed in the present case. There the statute in issue was Section 206-a-6 of the Revenue Act of 1921, which defines "capital assets" to be "property acquired and held by the taxpayer * * * for more than two years." The question in issue was whether the words "held by the taxpayer * * * for more than two years" allowed the tacking together of the tenure of a donor and trustee of a trust, so as to extend the capital gain tax rate to profits realized by the trustee from the sale of capital assets within two years from the date of the creation of the trust. The Commissioner pointed out the fact that long-continued rulings of the Income Tax Unit of the Bureau of the Bureau of Internal Revenue and the courts were against the trustee's contention. It was pointed out that the Revenue Act of 1926, Section 208-a-8, contained a rule for determining the period for which a taxpayer has held capital assets, substantially similar to the construction for which the trustee contended, and that said change constituted new law. The Court examined the intent of Congress in passing the legislation and ruled that its remedial nature entitled the trustee to tack tenures. In respect of the additions to the statute made by the Revenue Act of 1926, the Court stated:

"Mere change of language does not necessarily indicate intention to change the law. The purpose of the variation may be to clarify what was doubtful and so to safeguard against misapprehension as to existing law. In view of the inclusion of the same definition in the Acts of 1921, 1924 and 1926 and the legislative purpose underlying it, the contention that the new words were added to change the meaning of 'capital assets' as defined in the earlier acts is without force. *The definition so clarified was not new law but 'a more explicit expression of the purpose of the prior law.'*" *Jordan v. Roche*, 228 U. S. 436, 445, 57 L. Ed. 908, 911, 33 S. Ct. 573." (Italics ours.)

In *Sherman & Bryan v. Blair*, 35 Fed. (2d) 713 (C. C. A. 2d, 1929), the taxpayer attempted to charge off a portion of a bad debt under Section 234(a) of the Revenue Act of 1918 (40 Stat. 1077), which provided:

“(5) Debts ascertained to be worthless and charged off within the tax year.”

The Commissioner argued that the above section only permitted the charge-off of a debt *entirely worthless* and cited in support of that contention the fact that the Revenue Act of 1921, 42 Stat. 255, Section 234-a-5 provided as follows:

“(5) Debts ascertained to be worthless and charged off within the taxable year and when satisfied that a debt is recoverable only in part the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.”

This, he argued, constituted new law which was not retroactive. The Court permitted the partial charge-off of the debt, stating:

“But such subsequent legislation is not conclusive that the construction claimed for the earlier act must be accepted. See *Russell v. United States*, 278 U. S. 181, 188, 49 S. Ct. 121, 73 L. Ed. 255. ‘Debts ascertained to be worthless’ might, it would seem, reasonably be construed to mean ‘indebtedness ascertained to be worthless,’ and to permit a charge-off of such part of a claim as was proven to be uncollectible by so definite an event as seizure of the debtor’s property by a receiver.”

See also *Davidson Grocery Co. v. Lucas*, 37 Fed. (2d) 806 (Ct. App., D. C., 1930).

Petitioner respectfully submits that the Circuit Court of Appeals for the Ninth Circuit completely misconstrued the intent of Congress in amending the capital gains statute, and that, as held by the First Circuit Court of Appeals in *Averill v. Commissioner* (Appendix D), it constituted a more explicit declaration of the purpose and intent of the capital gains provisions from 1921 to date.

CONCLUSION.

1. The surrender by the taxpayer of bonds of the Elton Corporation for redemption during the years 1927, 1928 and 1929 was an exchange or sale of capital assets within the meaning of the provisions of the Revenue Acts of 1926 and 1928, and the excess of the sum received by the taxpayer over and above cost basis to the taxpayer was capital gain within the meaning of the Revenue Acts of 1926 and 1928 and was taxable to him at the flat rate of $12\frac{1}{2}\%$ instead of at the higher rates (normal and surtaxes).

2. The judgment of the Circuit Court of Appeals for the Ninth Circuit and the judgment of the District Court for the Southern District of California, Central Division, should be reversed and the complaint dismissed.

Respectfully submitted,

ARTHUR F. DRISCOLL,
Counsel for Petitioner.

APPENDIX A.

I. T. 1637, appearing at II-1 C. B. 36, provides:

"REVENUE ACT OF 1921.

Non-interest-bearing obligations of a political subdivision of a State were issued at 88 and upon maturity in the latter part of 1923 a taxable profit of 6 x will be realized by the holder not the original purchaser. Inasmuch as the obligations have been held for over two years inquiry is made whether the taxpayer will be subject to a tax on the capital net gain derived therefrom at the rate of 12½ per cent."

Section 206 of the Revenue Act of 1921, reads, in part, as follows:

"(a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

When an obligation matures it is neither sold nor exchanged. Any taxable profit derived upon maturity of a non-interest-bearing obligation is, therefore, not 'capital gain' derived from the sale or exchange of capital assets and section 206 does not apply."

APPENDIX B.

I. T. 2488, reported in VIII-2 C. B. 127, provides as follows:

"REVENUE ACTS OF 1921, 1924, 1926 AND 1928."

The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed as a capital net gain under the provisions of section 206 of the Revenue Act of 1921. I. T. 1637 (C. B. II-1, 36) revoked.

Likewise, any individual who has held stock in a corporation for more than two years and who derives

a gain when the stock is 'called in' may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

The foregoing ruling is also applicable under the Revenue Acts of 1924, 1926 and 1928.

A ruling is requested as to the manner in which the gain from bonds or stock held for more than two years should be treated where the bonds are redeemed before their maturity date or the stock is 'called in.'

Under the provisions of section 206 of the Revenue Act of 1921, any taxpayer (other than a corporation) who for any taxable year derives a capital net gain may elect to be taxed on such capital net gain at the rate of 12½ per cent. in lieu of the tax he would otherwise pay on such income under sections 210 and 211. Section 206 of the Revenue Act of 1921 reads, in part, as follows:

(a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

In I. T. 1637 it was held that when an obligation matures it is neither sold nor exchanged. It was further held that any taxable profit derived upon maturity of an obligation is therefore not 'capital gain' derived from the sale or exchange of capital assets and section 206 does not apply.

Under date of February 19, 1929, the United States Board of Tax Appeals decided, in the case of Henry P. Werner (15 B. T. A. 482, see on page 56), that the redemption of bonds at a 'called' date for an amount in excess of the cost of the bonds to the bondholder results in a gain from the sale or exchange of capital assets within the meaning of section 206 of the Revenue Act of 1921. In the decision the legislative history of section 206 of the Revenue Act of 1921 was reviewed. It was stated that the Ways and Means Committee of the House and the Finance Committee of the Senate declared that the provision was intended to be applicable to the 'sale or other disposition of capital assets.'

The ruling contained in I. T. 1637 is hereby revoked. The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed under the provisions of section 206 of the Revenue Act of 1921.

Likewise, any individual who has held stock in a corporation for more than two years and who derived a gain when the stock is 'called in' may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

As the provisions of the Revenue Acts of 1924, 1926 and 1928 relating to capital net gains are similar to the provisions of section 206(a)(1) of the Revenue Act of 1921, the foregoing ruling is also applicable under those Acts."

APPENDIX C.

I. T. 2678, appearing in XII-1 C. B. 117, is as follows:

"Revenue Acts of 1921, 1924, 1926 and 1928.

I. T. 2488 (C. B. VIII-2, 127), which holds that the gain derived from stock of a corporation 'called in,' or the gain derived from bonds as the result of their maturity or redemption before maturity, where such stock or bonds have been held for more than two years, may be taxed as a capital net gain, is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, Jr. v. Commissioner* (27 B. T. A. 463, page 13, this Bulletin)."

APPENDIX D.**UNITED STATES CIRCUIT COURT OF APPEALS****FOR THE FIRST CIRCUIT****OCTOBER TERM, 1938.**

FRANCES M. AVERILL,
Petitioner for Review,

v.

COMMISSIONER OF INTERNAL REVENUE.

No. 3376.

**PETITION FOR REVIEW OF A DECISION OF THE UNITED STATES
 BOARD OF TAX APPEALS.**

BEFORE BINGHAM, WILSON AND McLELLAN, JJ.

Opinion of the Court.

December 28, 1938.

McLELLAN, J. This petition to review a decision of the Board of Tax Appeals presents the question whether the gain realized by the petitioner when bonds owned by her were paid at maturity in 1931 should be taxed as ordinary income. The Board decided that such gain should be taxed as ordinary income; the petitioner urges that it should be taxed as capital gain at the maximum rate of 12½ per cent. The Board erred and the petitioner should prevail:

1. If a transaction in 1927 in which she parted with some stock and received cash and bonds was a sale for a price payable by installments and not as to her a statutory reorganization; or

2. If, though the 1927 transaction was not a sale, the 1931 surrender of her bonds then maturing for which she received payment was a "sale or exchange" within the meaning of the Revenue Act of 1928.

The reason the petitioner should prevail if she sold her stock in 1927 is that the rights of the parties would then be governed by a statute permitting the taxpayer who sells or otherwise disposes of property on the installment plan to return as income in any taxable year that portion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the total contract price (Revenue Act of 1926, Section 212(d)), and by a statute giving the taxpayer in case of a capital net gain an election to pay a 12½ per cent tax thereon (Revenue Act of 1928, Section 101(a)). The reason the petitioner should prevail if the transaction by which she gave up her bonds and received payment therefor in 1931 constituted a sale or exchange of the bonds is that in such a case the statute last cited gives the taxpayer an option to pay a 12½ per cent tax on a capital gain, which Section 101(c) of the Revenue Act of 1928 defines as "a taxable gain from the sale or exchange of capital assets."

We proceed to state the facts material to these two questions.

For more than two years prior to January 1, 1927, the petitioner had owned 1500 shares of the common stock of Keyes Fiber Company, hereafter sometimes called the old company. This corporation at all times here material had outstanding but one issue of stock—its common stock, of which there were 6000 shares.

On July 27, 1927, the petitioner, her husband George S. Averill and other shareholders representing in all 5912 shares, entered into a contract with the Rex Pulp Products Company, hereinafter called Rex. In this contract the shareholders of the old company, referred to therein as "the vendors," agreed to "sell, assign and convey all the shares owned by them to a new corporation to be organized under the laws of Maine, hereinafter known as the vendee, to be called Keyes Fiber Company, Inc., or some similar name, at the agreed purchase price of seven hundred fifty (750) dollars per share." Rex agreed "that it will cause the vendee to pay to each of said vendors on or before the 11th day of August, 1927, at the Fidelity Trust Company, Portland, Maine, for the num-

ber of shares of stock in said company which said vendors shall properly deliver to the order of the vendee at the Fidelity Trust Company, Portland, Maine, the sum of seven hundred fifty (750) dollars per share." Rex also agreed that "such payments shall be made as follows, viz: $\frac{5}{9}$ (five ninths) of the purchase price for said shares shall be paid in the first mortgage bonds of the vendee and the remaining $\frac{4}{9}$ (four ninths) of such price shall be paid in cash." It was further agreed that the proportion of bonds and cash paid to the individual vendors should be as agreed upon among themselves. The contract provided in substance that the first mortgage bonds should constitute a first lien on all the property "now or hereafter acquired" by either the old company, or Rex, or the corporation to be organized.

Later, Keyes Fiber Company, Inc., hereafter sometimes called the new company, was organized. On August 11, 1927, certain corporate votes were passed by the old Company, Rex, and the new company. The new company first acquired all the assets of Rex in exchange for its own common stock. It then assumed those obligations which the contract of July 27 provided that it should assume, and voted to purchase the 5912 shares of the old company as provided in the contract. The stock of the old company was then assigned to the new company, which immediately pledged it to a trustee as security for the performance of its obligations under the contract. The old company then conveyed all its assets to the new company for the agreed price of \$4,500,000, and this sum was paid to it by the new company, $\frac{4}{9}$ s in cash and $\frac{5}{9}$ ths in bonds. The old company then made a liquidating dividend to its stockholders of \$750 a share, $\frac{4}{9}$ ths in cash and $\frac{5}{9}$ ths in bonds, and was later dissolved. This dividend was received by the new company as holder of the stock of the old company, and was immediately transferred to the former stockholders of the old company in exchange for their stock, in accordance with the terms of the contract of July 27 and of the pledge to the trustee. While, as heretofore stated, the contract of July 27, 1927 provided that the purchase price of the stock should be paid $\frac{5}{9}$ ths in bonds of the vendee and $\frac{4}{9}$ s in cash, there was a provision that "the proportion of

payment of bonds and cash should be such as is agreed upon among said vendors." Accordingly, the petitioner received \$275,000 cash, which was just less than 25 per cent of the purchase price, and \$850,000 in serial bonds which were of the par value of \$1,000 cash and worth par when received in 1927. One tenth of the petitioner's 850 bonds matured in each of the years 1931 to 1936 inclusive and four tenths in 1937.

At all material times up to August 11, 1927, the date on which the petitioner disposed of her stock in the old company, her husband, Dr. George G. Averill, was a large stockholder, a director, treasurer and clerk of the old company. The petitioner held no office in the old company. Neither Dr. nor Mrs. Averill held any office in Rex Pulp Products Company or the new company at any time, nor did either of them hold any office in the old company at any time after the petitioner disposed of her stock. Thus it appears that so far as the petitioner is concerned all she did was to transfer her stock in the old company for cash and serial bonds of the transferee.

As heretofore indicated, the first question is whether the transaction in 1927 was tantamount to a sale by the taxpayer of her corporate stock for a price to be paid in installments.

The Board decided and the Commissioner contends that it was not a sale but an exchange by a party to a reorganization of stock in a corporation for securities in another corporation in pursuance of the plan of reorganization. Some of the essentials of a statutory reorganization inhered in what was done in 1927. These we think it unnecessary to discuss in detail. That the corporate bonds may be deemed "securities" within the meaning of the reorganization provisions of the statute is settled by *Helvering v. Watts*, 296 U. S. 387, where the Supreme Court said: "The bonds, we think, were securities within the definition, and cannot be regarded as cash, as were the short term notes referred to in *Pinellas Ice and Cold Storage Company v. Commissioner*, 287 U. S. 462." The decision that the bonds there involved "were securities within the definition, and cannot be regarded as cash" is referable to

a contract where no sale but only an exchange for stock and bonds was intended. An inspection of the contract in that case, appearing in 28 B. T. A. 1056, shows that the parties contemplated no sale, but only an exchange of stock for stock and bonds. Consistent with the rest of the contract are the clauses reading:

"Whereas, said Parker Sloane is exchanging and delivering to and with the Vanadium Corporation of America Thirty Thousand (30,000) shares of the stock of the United States Ferro Alloys Corporation, * * * and

"Whereas, the Vanadium Corporation of America is exchanging and delivering to said Parker Sloane, Trustee for the owners of said United States Ferro Alloys Corporation" (certain shares of stock together with certain bonds).

We understand the Watts case as holding that bonds may be deemed securities, and that if treated as such, they cannot be regarded as cash. It does not indicate that where, as in the case at bar, a person expresses his intention to sell and another to buy corporate stock and both parties contemplate a sale for a price payable by installments, that the transaction loses its character as such just because the vendee's obligation is represented in part by serial bonds. Neither does the Watts case nor, so far as we know, any other decision of the Supreme Court of the United States, decide that the ownership of bonds without stock ever constitutes such a continuing interest as is essential to a statutory reorganization, a question which we are not called upon to decide. Cf. *Worcester Salt Company v. Commissioner*, 75 Fed. (2d) 251 (C. C. A. 2d) and *Lilienthal v. Commissioner*, 80 Fed. (2d) 411 (C. C. A. 9th).

The instant case discloses that the taxpayer contracted to sell her stock at \$750 a share and the new corporation undertook to buy it at that price. The total price was to be paid, as to about 25 per cent thereof, in cash and the balance over a period of years. The petitioner's husband then relinquished

his connections with the old company and had nothing to do with the management of the new one. Both intended to get out of the business and the new company intended that they should. The substance of the transaction was a sale by installments and the serial bonds were treated merely as a convenient method of providing for the installment payments. We see no adequate reason for saying that the intention of the parties should not be given effect. As to the taxpayer, the transaction amounted to a sale of her stock, not an exchange "by a party to a reorganization of stock in a corporation for securities in another corporation, a party to the reorganization, in pursuance of the plan of reorganization."

As before stated the taxpayer sold her stock in 1927 for a price payable in installments. Within the meaning of the statute she did not exchange it for securities in another corporation. The sale was casual, the purchase price exceeded \$1,000 and the initial payment received in cash other than evidences of indebtedness of the purchaser during the year in which the sale was made and did not exceed one-quarter of the purchase price. In short, the transaction was within Section 212 of the Revenue Act of 1926, which permits the return in any taxable year of "that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the whole contract price."

In her tax return for 1927 the petitioner reported gains from the disposition of her stock upon the installment basis and upon that basis her income tax for that year was paid. The Commissioner made no adjustment of the tax as to the petitioner, though he "disallowed the use of the installment basis as to Dr. George G. Averill and computed the gain under the reorganization exchange provisions." In the position then taken by the taxpayer she was right. Collection of the serial bonds falling due in 1931, with which we are here concerned, involved a net gain which, by virtue of Section 101 of the Revenue Act of 1928, is taxable at $12\frac{1}{2}$ per cent.

We now come to a different question. If the 1927 transaction were governed by the statutory reorganization provisions, it would not follow necessarily that the Board's de-

cision is correct. When in 1931 the taxpayer surrendered her bonds then maturing and received payment therefor, she realized a gain over their stipulated cost. Her right to treat this profit as a capital gain taxable at the rate of 12½ per cent depends upon the portions of the Revenue Act of 1928 which follows:

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) Tax in case of capital net gain.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus 12½ per centum of the capital net gain.

(c) Definitions.—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets.

* * * * *

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years * * *

At the outset we are confronted with the question whether it is so clear that the words "taxable gain from the sale or exchange of capital assets" do not include a transaction whereby bonds are redeemed at maturity that we are not permitted to use the canons of interpretation commonly used where the question is fairly debatable. If it were true that in the very nature of things a covenantee cannot sell a bond or

other specialty to the covenantor, this would tend to support the Board's decision. But we think the holder can sell the bond to anybody. The incidents of such sales vary. If the bond is sold to a stranger, he gets it and with it the right to enforce it. If an attempted sale is made to the covenantor, he gets the bond though he acquires no right to enforce it. Perhaps one way to put it is that in either case there is a sale or transfer of title for a price—that in one case the subject matter of the sale is the bond as a valid obligation, and that in the other case the subject matter of the sale is the bond as something calculated no longer to represent contractual rights. It makes no difference whether the transaction is regarded as the sale of a contract right to a stranger or as a sale of a "piece of paper" to the covenantor. In either case the original holder may be regarded as having realized a gain from the sale of a specialty.

In prior decisions and in the case at bar the Board adheres to the view that preferred stock may be sold to the corporation which issued it. *Helvering v. Schoellkopf*, recently decided by the Second Circuit and not yet reported, indicates that within the meaning of the reorganization statute a corporation's own shares cannot be regarded as "property acquired" by it. But we find nothing there requiring the conclusion that a bond, particularly in a state where the distinction between sealed and unsealed instruments has not been abolished, cannot be sold to its maker.

Moreover, a transaction whereby a holder surrenders his bond and receives payment thereof or therefor has commonly been called a redemption, which derivatively and according to the dictionaries, and Judge Wilson's opinion while Chief Justice of the Maine Supreme Court, is a repurchase. *Bernstein v. Blumenthal*, 127 Me. 393, 396.

We think the proper construction of the words "taxable gain from the sale or exchange of capital assets" sufficiently debatable to warrant a brief reference to the history of this clause of the statute.

The first legislation according special treatment to capital gains is in the Revenue Act of 1921. There the definition of capital gain as "taxable gain from the sale or exchange of

capital assets" first appeared. It reappeared in the intervening Acts and that of 1932. Referring to the purpose of the Congress in passing the Revenue Act of 1921, the Supreme Court of the United States in *Burnet v. Harmel*, 287 U. S. 103, 106, said:

" * * * The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

Prior to the Revenue Act of 1928, here applicable, the practice had been to treat gains incident to the redemption of bonds as ordinary income. The tendency of the use of the same language in the 1928 Act was to indicate a congressional intent to the same effect. But after the 1928 Act was passed there was a series of events pointing another way.

In *Werner v. Commissioner*, 15 B. T. A. 482, the Board of Tax Appeals in 1929 recited the legislative history of the statutory definition now under consideration and concluded that the redemption of "called" bonds constituted a "sale or exchange." It may be stated parenthetically that no importance was attributed to the fact that the bonds were "called" and we do not see how that fact is of consequence. After this decision by the Board, the Commissioner in IT 2488 (2 C. B. 127) revoked his previous ruling and directed that the net gains from bonds held for more than two years received as a result of the maturity of the bonds or as a result of their redemption before maturity may, at the option of the taxpayer, other than a corporation, be taxed under the capital gains section of the Revenue Act of 1921. This ruling was also made applicable to the Revenue Acts of 1924, 1926, and 1928. As stated in the petitioner's brief, "thus, from 1929 until December 1932, the ruling of the administrative department of the Government in charge of the collection of income taxes, as well as the ruling of the Board, interpreted the statute in accord with the petitioner's contention." In the

light of this interpretation, Congress in 1932 reenacted its definition of "capital gain" in precisely the same language. Unless the Werner case was plainly erroneous, and we do not think it was, this reenactment of the statute might well be considered as a satisfactory interpretation of the legislative intent. *Buttolph v. Commissioner*, 29 Fed. (2d) 695 (C. C. A. 7th, 1928). See also *Hassett v. Welch*, 303 U. S. 303.

On December 29, 1932, the Board of Tax Appeals reversed the Werner decision (*Watson v. Commissioner*, 27 B. T. A. 463). Thereafter, as shown in a publication of the Government Printing Office entitled "Revenue Revision, 1934, Hearing before the Committee on Ways and Means, House of Representatives, 73d Congress, Second Session, December 15 to 21, 1933 and January 9 to 11, 1934," the American Bar Association recommended that the Congress re-define the terms "capital gain" and "capital loss" to make clear whether such terms include gains and losses resulting from the redemption at maturity of capital assets. In the Revenue Act of 1934 it was provided:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) General Rule.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: (there follows a statement as to the percentages).

In subdivision (f) of the same section it was provided that "for the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation * * * shall be considered as amounts received in exchange therefor."

There seem to us two admissible views as to the bearing of this legislation, one that it constitutes a legislative declaration of the meaning of the word "exchange" and governs the construction of the word in prior Acts, the other the view

expressed by the Circuit Court of Appeals for the 9th Circuit in the following language:

"When Congress determined, as it did in 1934, to treat as 'capital gains' gains resulting from the retirement of bonds issued by a government or corporation, it had no difficulty in expressing its intent in clear and unambiguous language. Revenue Act of 1934, Sec. 117 (f), 48 Stat. 715, 26 U. S. C. A. Sec. 101 (f). If such intent had existed prior to 1934, it could and, we think, would have found similar expression."

United States v. Fairbanks, 95 Fed. (2d) 794, 796.

Though the question seems to us a close one, we think under all the circumstances that the doctrine enunciated by Chief Justice Marshall in *Alexander v. The Mayor of Alexandria*, 5 Cranch 1, is here relevant. He there said:

"Without deciding this question as depending merely on the original law, it is to be observed that acts *in pari materia* are to be construed together as forming one act. If in a subsequent clause of the same act provisions are introduced, which show the sense in which the legislature employed doubtful phrases previously used, that sense is to be adopted in construing those phrases. Consequently, if a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language the rule which has been stated, requiring that the subsequent should be incorporated into the foregoing act, is a direction to courts in expounding the provisions of the law."

This language is quoted in full in this court's opinion in *Panther Rubber Co. v. Commissioner*, 45 Fed. (2) 314, where Judge Wilson also said:

"Congress, by substitute provisions, *in pari materia* with section 250 of the Revenue Act of 1921, has indicated that such was its intent, and has made it clear in the act of 1924 and especially in the Revenue Act of

1928. In the Revenue Act of 1924, Sec. 278 (c), Congress provided that assessment and collection may be had after the expiration of the statutory period, where the taxpayer and commissioner, 'have consented,' indicating a past act. This might not be conclusive, but Congress in the Revenue Act of 1928 clearly indicated its intent (see chapter 852, Sec. 276 (26 U. S. C. A. Sec. 2276)), and required the waiver to be signed before the limitation period for assessing the tax expired."

See also:

Old Colony Trust Company v. Malley, 19 Fed. (2d) 346.

We think the taxpayer's 1931 gain not taxable as ordinary income, but as capital gain at the maximum rate of 12½ per cent because the 1927 transaction was a sale for a price payable in installments not affected by the reorganization provisions of the statute, and because, if this is not so, the redemption of her bonds in 1931 resulted in a "capital gain" within the meaning of the statutory definition of that term.

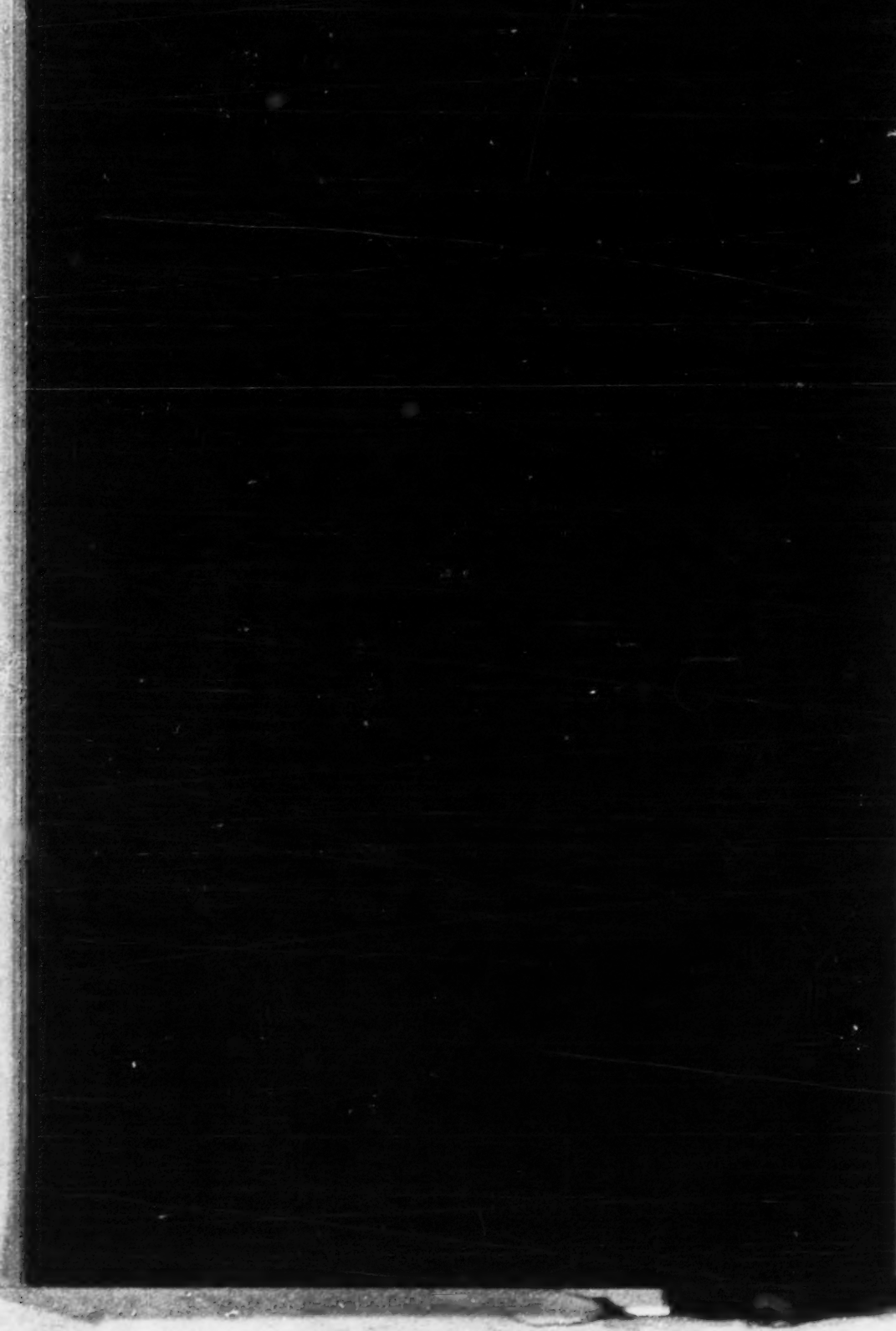
The decision or order of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.



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OF PETITIONS FOR WRITS OF HABEAS CORPUS IN THE UNITED
STATES MARSHAL SERVICE FOR THE DISTRICT OF COLUMBIA
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FILED FOR THE DISTRICT OF COLUMBIA



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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 65

DOUGLAS FAIRBANKS, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE NINTH
CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 51-55) is not officially reported. The opinion of the Circuit Court of Appeals (R. 132-138) is reported in 95 F. (2d) 794.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 2, 1938. (R. 139.) Petition for certiorari was filed May 28, 1938. The jurisdiction of this Court is invoked under Section 240 (a) of

the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the redemption and retirement in 1927, 1928, and 1929 of certain corporate bonds, pursuant to their terms, constitute the sale or exchange of a capital asset within the meaning of Sections 208 and 101 of the Revenue Acts of 1926 and 1928, respectively.

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

* * * * *

The provisions of Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, are substantially identical with the above.

STATEMENT

The pertinent facts, among others found by the District Court (R. 59-74), may be summarized as follows:

Petitioner owned several motion pictures upon which his cost basis was \$1,096,445.52. On March 5, 1925, he entered into a contract with the Elton Corporation, under which he transferred to that corporation his interest in the motion pictures in

exchange for \$4,000,000 par value of its bonds, to mature March 5, 1935, and 990 shares of its no-par-value stock. (R. 60.)

The bonds contained a provision permitting their redemption by the corporation at any time upon 30 days' notice to the registered holder thereof. Under the contract the Elton Corporation obligated itself to redeem \$100,000 face value of the bonds per year, beginning three years after the date of the contract. (R. 60.) The corporation did redeem, and petitioner surrendered for redemption, \$1,600,000 of such bonds in 1927; \$150,000 in 1928, and \$150,000 in 1929. (R. 60-61.)

Petitioner in his income tax returns for 1927 and 1928 reported the sums received from the redemption of the bonds. (R. 62, 63.) He took no deduction for cost, but reported the full amount received as taxable at the capital gain rate of $12\frac{1}{2}$ percent. For the year 1929 petitioner reported the amount received from the redemption of the bonds at the capital gain rate of $12\frac{1}{2}$ percent, but claimed a proportionate amount of a total cost basis, which was less than the amount later agreed upon as the total cost basis in a settlement for prior years. (R. 65-66.)

In December, 1929, petitioner and the Commissioner of Internal Revenue reached a settlement for the years 1917-1926, under which there was left to petitioner an unrecouped, unamortized cost of pictures of \$1,096,445.52. (R. 64.)

Petitioner filed claims for refund for the years 1927, 1928, and 1929, setting forth that he had not used the proper cost basis for the bonds redeemed. (R. 67-68.) The Commissioner on January 26, 1932, refunded to petitioner for the year 1927 \$53,231.55, together with interest in the sum of \$9,709.05; for the year 1928 \$7,507.38, with interest in the sum of \$932.40; for the year 1929 \$677.56, with interest in the sum of \$42.99. (R. 72-73.) Thereafter, the Commissioner of Internal Revenue determined that the refunds were erroneous,¹ and on July 6, 1933, officially demanded return to the Government of the sums refunded. (R. 73-74.) No part of the sums refunded has been returned. (R. 74.)

This action at law was instituted in the District Court on January 20, 1934 (R. 24), in accordance with Section 610 of the Revenue Act of 1928, to recover the sums of money erroneously refunded to the petitioner, together with interest thereon, at 6 percent per annum from the date of payment thereof. The refund was alleged to be erroneous because the amounts received from the Elton Corporation should have been taxed as income and not

¹ In fact, application of both normal and surtax rates to the income shown in Findings XV (R. 62), XVII (R. 63) and XXIII (R. 65-66) discloses that in addition to the sums erroneously refunded, petitioner's tax had been underpaid: for 1927, by \$91,160.64, for 1928, by \$5,257.43, and for 1929, by \$7,322.10. However, because of the bar of the statute of limitations, these sums are not involved in this suit.

as capital gain. (R. 29, 35, 40). Jury was waived and the case was tried to the court, which held that the redemption of the bonds was not a "sale or exchange," and rendered judgment for the respondent in the sum of \$72,186.94, with interest at 7 percent per annum from the date of demand of the return of the erroneous refunds to the date of judgment. (R. 76-77.) On cross-appeals, the Circuit Court of Appeals affirmed, with the modification that interest was allowed on the erroneous refunds at 6 percent per annum from the date of the payment of the said refunds. (R. 139.)

ARGUMENT

The question is narrowed to whether or not the redemption of the bonds, pursuant to their terms, was a sale or exchange within the meaning of Section 208 (a) (1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, and Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791. These sections are substantially identical, providing:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

* * * * *

While the Board of Tax Appeals first held to the contrary (*Werner v. Commissioner*, 15 B. T. A. 482), the lower tribunals are now in accord that "sale" or "exchange", as used in the above sections, should

be given their well-established meaning; and that the redemption of the bonds, pursuant to their terms, is not a sale or an exchange.² *Watson v. Commissioner*, 27 B. T. A. 463; *Braun v. Commissioner*, 29 B. T. A. 1161; *Rands v. Commissioner*, 34 B. T. A. 1107; *Brown v. Commissioner*, 36 B. T. A. 178; *Hale v. Helvering*, 85 F. (2d) 819 (App. D. C.); *Felin v. Kyle*, 22 F. Supp. 556 (E. D. Pa.); see, also, *Hellman v. Commissioner*, 33 B. T. A. 901.

These decisions are correct. The redemption and retirement of the bonds constituted neither a sale nor an exchange of capital assets, but payment, pursuant to call, of a fixed corporate obligation in accordance with its terms. The bonds on their face provided for their redemption at any time, at face value plus interest, upon notice to the registered holder thereof. (R. 60.) The corporation so redeemed, and thus extinguished its obligations.

None of the elements of a sale or exchange is present. There was no transfer of title; there was a mere payment of a debt, and return of the evidence of that debt. "Sale" and "exchange" connote a transfer of property to a new owner. Neither can be one-sided. There can be no sale without a purchase. There can be no exchange unless there be property parted with and property received by both parties. Certainly the corpora-

² Compare *McKee v. Commissioner*, 35 B. T. A. 239, holding the gains taxable as capital gains when the bonds are sold to a third person shortly before the redemption sale.

tion received no property for the cash it paid. The bonds it had issued were mere evidence of its obligation. *Commissioner v. Great Western P. Co.*, 79 F. (2d) 94, 96 (C. C. A. 2d), affirmed, 297 U. S. 543. Upon payment of the obligation, in accordance with its terms, that evidence was returned to the corporation.

Furthermore, a change of the law was necessary to include sums received from the redemption of bonds in capital gain. *Felin v. Kyle*, *supra*. This change is found in Section 117 (f) of the Revenue Act of 1934,³ c. 277, 48 Stat. 680, which provides:

SEC. 117. * * *

(f) RETIREMENT OF BONDS, ETC.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

CONCLUSION

The decision below is correct. It is not in conflict with decisions of other courts. There are but few cases involving the question. The governing

³The committee reports do not explain why this change was made. H. Rept. No. 704, 73rd Cong., 2d Sess., p. 31; Sen. Rept. No. 558, 73rd Cong., 2d Sess., p. 11-13, 38.

statute has been changed. The petition should therefore be denied.

Respectfully submitted.

ROBERT H. JACKSON,
Solicitor General

JAMES W. MORRIS,
Assistant Attorney General

✓
SEWALL KEY,

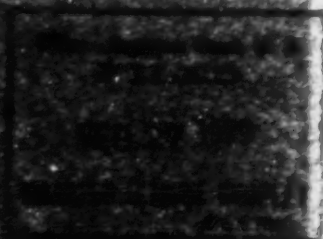
A. F. PRESCOTT,

Special Assistants to the Attorney General

JULY, 1938.



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INDEPENDENT INVESTIGATION

REPORT OF THE

COMMISSIONER OF THE

**AT THE OFFICE OF THE ATTORNEY GENERAL
STATE OF MISSISSIPPI FOR THE YEAR 1907**

MISSISSIPPI, THE GREAT SOUTH

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In the Supreme Court of the United States

OCTOBER TERM, 1938

No. 65

DOUGLAS FAIRBANKS, PETITIONER

v.

UNITED STATES OF AMERICA

**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE NINTH CIRCUIT**

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the District Court is not officially reported, but is found in the record (pp. 51-55). The opinion of the Circuit Court of Appeals (R. 132-138) is reported in 95 F. (2d) 794.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 2, 1938 (R. 139). Petition for certiorari was filed May 28, 1938, and denied October 10, 1938. Upon petition for rehearing, order allowing certiorari was filed January 16, 1939 (R. 142). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the redemption and retirement in 1927, 1928, and 1929 of certain corporate bonds, pursuant to their terms, constitute the sale or exchange of a capital asset within the meaning of Sections 208 and 101 of the Revenue Acts of 1926 and 1928, respectively.

STATUTES INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921; * * *

The provisions of Section 101 (c) (1) of the Revenue Act of 1928, c. 852, 45 Stat. 791, are identical with the above.

STATEMENT

Petitioner owned several motion pictures upon which his basis for cost was \$1,096,445.52. On March 5, 1925, he entered into a contract with the Elton Corporation, under which he transferred to that corporation his interest in the motion pictures in exchange for \$4,000,000 par value of its bonds, to mature March 5, 1935, and 990 shares of its no-par-value stock (R. 60).

Under the contract the Elton Corporation obligated itself to redeem \$100,000 face value of the bonds per year, beginning three years after the date

of the contract. The bonds contained a provision permitting their redemption by the corporation at any time upon 30 days' notice to the registered holder thereof (R. 60). The corporation did redeem, and petitioner surrendered for redemption, \$1,600,000 of such bonds in 1927, \$150,000 in 1928, and \$150,000 in 1929 (R. 60-61).

Petitioner in his income-tax returns for 1927 and 1928 reported the sums received from the redemption of the bonds (R. 62, 63). He took no deduction for cost, but reported the full amount received as taxable at the capital gain rate of 12½ percent. For the year 1929 petitioner reported the amount received from the redemption of the bonds at the capital gain rate of 12½ percent, but claimed a cost of less than the amount later agreed upon in a settlement for prior years (R. 65-66).

In December 1929, petitioner and the Commissioner of Internal Revenue reached a settlement for the years 1917-1926, under which there was left to petitioner an unrecouped, unamortized cost of pictures of \$1,096,445.52 (R. 64).

Petitioner filed claims for refund for the years 1927, 1928, and 1929, setting forth that he had not used the proper cost for the bonds redeemed (R. 67-71). The Commissioner on January 26, 1932, refunded to petitioner for the year 1927, \$53,231.55, together with interest in the sum of \$9,709.05; for the year 1928, \$7,507.38, with interest in the sum of \$932.40; for the year 1929, \$677.56, with interest

in the sum of \$42.99 (R. 72-73). Thereafter the Commissioner of Internal Revenue determined that the refunds were erroneous because the redemptions were not to be treated as capital gain,¹ and on July 6, 1933, officially demanded return to the Government of the sums refunded (R. 73-74). No part of the sums refunded has been returned (R. 74).

This action at law was instituted in the District Court on January 20, 1934 (R. 24), in accordance with Section 610 of the Revenue Act of 1928, to recover the sums of money erroneously refunded to the petitioner, together with interest thereon, at 6 percent per annum from the date of payment thereof. Jury was waived and the case was tried to the court, which held that the redemption of the bonds was not a "sale or exchange," and rendered judgment for the respondent in the sum of \$72,186.94, with interest at 7 percent per annum from the date of demand of the return of the erroneous refunds to the date of judgment (R. 76-77). On cross-appeals, the Circuit Court of Appeals affirmed, with the modification that interest was allowed on the erroneous refunds at 6 percent per annum from the date of the payment of the said refunds (R. 139).

¹ In fact application of both normal and surtax rates to the income shown in Findings XV (R. 62), XVII (R. 63), and XXIII (R. 65-66) discloses that in addition to the sums erroneously refunded, petitioner's tax had been *underpaid*: for 1927, by \$91,160.64, for 1928, by \$5,257.43, and for the year 1929, by \$7,322.10. However, because of the bar of the statute of limitations, these sums are not involved in this suit.

This Court first denied petition for writ of certiorari, but upon petition for rehearing thereof, which pointed out conflict with *Averill v. Commissioner*, decided by the United States Circuit Court of Appeals for the First Circuit December 28, 1938 (not yet reported but may be found in 1939 C. C. H., Vol. 4, p. 9494),² order allowing certiorari in the instant case was entered January 16, 1939 (R. 142).

SUMMARY OF ARGUMENT

The issue here has been narrowed to whether the redemption or retirement of bonds constitutes a "sale or exchange" within the meaning of the statutory definition of "capital gain." The statute on its face is plain and unambiguous and admits of no resort to rules of statutory construction applicable to statutes of doubtful meaning. The rule repeatedly expressed by this Court that the intent of Congress is to be sought from the language used, and where this expresses an intention reasonably intelligible and plain it must be accepted without modification by resort to construction or conjecture, is controlling herein and calls for the rejection of petitioner's contentions.

But even resort to the legislative history of the pertinent provision does not aid the petitioner. Such history, as well as the decisions of this Court,

² A copy of the opinion in *Averill v. Commissioner of Internal Revenue* is included in Brief for Petitioner, Appendix D, p. 36.

demonstrates that the statute is an inducing provision to encourage profit taking by offering a reduced tax to persons who would otherwise be reluctant to sell or exchange their capital assets. But it is clear that Congress could do nothing to encourage holders to redeem their bonds because the redemption was not a matter within their control. Thus it appears the original intent of the statute was to limit its benefits to those in a position to cooperate with the legislative policy and these benefits should not be extended by judicial construction in the absence of a clearly expressed intent.

The provision in question was first included in the Revenue Act of 1921 and re-enacted without modification in the subsequent acts until that of 1934. From 1921 to 1929 there was a uniform and consistent administrative interpretation which excluded redemption or retirement of bonds. Under established principles such interpretation is entitled to great weight and will not be disturbed except for compelling reasons, not present herein.

Moreover, the change made by the Revenue Act of 1934 was not of a declaratory or explanatory nature with respect to the intent of Congress under the prior acts. In such a situation the changes introduced into the later acts can not authorize construction of the earlier ones not consonant with the language there employed.

ARGUMENT

I

THE PERTINENT STATUTORY PROVISIONS ARE CLEAR AND UNAMBIGUOUS AND PERMIT OF NO JUDICIAL EXPANSION

The issue in the instant case has been narrowed to whether the "redemption" of bonds, pursuant to their terms, constitutes a "sale or exchange" of capital assets within the meaning of Section 208 (a) (1), Revenue Act of 1926, and Section 101 (c) (1), Revenue Act of 1928, so that the gain to petitioner upon such redemption is taxable at the "capital gain" rates rather than as ordinary income. These sections are substantially identical, providing:

SEC. 208. (a) For the purposes of this title—

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;

* * * * *

Petitioner asks that this Court by judicial construction add to the statutory definition of "capital gain" taxable gain derived from the *redemption* of capital assets as well as from the "sale or exchange" thereof. This, we submit, may not be done. The statute is plain and unambiguous. It

refers to and includes only "sales or exchanges." There is no room for construction to enlarge or limit its meaning.

The intention of Congress is to be sought for primarily in the language used, and where this expresses an intention reasonably intelligible and plain it must be accepted without modification by resort to construction or conjecture. The recent reiteration of the rule by this Court in *Helvering v. City Bank Co.*, 296 U. S. 85, 89, is particularly apposite here:

We are not at liberty to construe language so plain as to need no construction, or to refer to Committee reports where there can be no doubt of the meaning of the words used.

See also *Thompson v. United States*, 246 U. S. 547, 551; *Wilbur v. United States*, 284 U. S. 231, 237. This rule is applicable to taxing acts and to the definition of the words "sale or exchange," as used therein. *Old Colony R. Co. v. Commissioner*, 284 U. S. 552, 560; *Hale v. Helvering*, 85 F. (2d) 819, 821-822 (App. D. C.); *Watson v. Commissioner*, 27 B. T. A. 463; *Braun v. Commissioner*, 29 B. T. A. 1161; *Brown v. Commissioner*, 36 B. T. A. 178.

Accordingly, we submit that under fundamental principles of statutory construction petitioner's contentions here must be rejected.

II

THE REDEMPTION AND RETIREMENT OF THE CORPORATE BONDS INVOLVED DID NOT CONSTITUTE THE SALE OR EXCHANGE OF THE CAPITAL ASSETS WITHIN THE MEANING OF SECTIONS 208 AND 101 OF THE REVENUE ACTS OF 1926 AND 1928, RESPECTIVELY

Petitioner contends that the call and payment of the bonds by the obligor corporation in 1927, 1928, and 1929 must be treated to the taxpayer for capital gain purposes in like manner as "the sale or exchange of capital assets" under Sections 208 (a) and 101 (c), *supra*; and that the term "sale or exchange" means and includes such payment or redemption.

Respondents maintain that the redemption and retirement of the bonds constituted neither a sale nor an exchange of capital assets, but payment, pursuant to call, of a fixed corporate obligation in accordance with its terms. The bonds on their face provided for their redemption at any time, at face value plus interest, upon notice to the registered holder thereof (R. 60). The corporation so redeemed and thus extinguished its obligations.

None of the elements of a sale or exchange is present. There was no transfer of title; there was a mere payment of a debt, and return of the evidence of that debt. "Sale" and "exchange" connote a transfer of property to a new owner. Neither can be one-sided. There can be no sale with-

out a purchase. There can be no exchange unless there be property parted with and property received by both parties. Certainly the corporation received no property for the cash it paid. The bonds it had issued were mere evidence of its obligation. *Commissioner v. Great Western P. Co.*, 79 F. (2d) 94, 96 (C. C. A. 2d), affirmed, 297 U. S. 543. Upon payment of the obligation, in accordance with its terms, that evidence was returned to the corporation.

It is plain, we submit, the taxable gain from the retirement and redemption of bonds is neither within the language nor the intent of the statute, which limits the special treatment provided therein to gains from the "sale or exchange" of capital assets. First of the revenue acts according special treatment to capital gains was that of 1921. The provision was reenacted in substantially identical form and was in effect under all the revenue acts from 1921 until 1934.

Petitioner concedes (Br. 10-11), the legislative history of the original provision shows (Pet. Br. 12-13), and this Court has held (*Burnet v. Harmel*, 287 U. S. 103) that these capital gain provisions were enacted for the purpose of relieving taxpayers coming within their provisions from excessive tax burdens on gains resulting from a sale or exchange of capital assets and to encourage their sale or exchange.

Thus it is generally recognized that the pertinent sections are inducing provisions. They grant a

reward (a reduction in rate) to those in a position to take advantage of their application. In cases where a taxpayer with a large increment in his investment hesitates to sell or exchange his holdings because of a high tax resulting therefrom, Congress by these provisions has encouraged such a person to dispose of such assets (sale or exchange) by granting a lower rate than that placed upon ordinary income. But it will be seen that the very purpose of these provisions can be of no effect in cases of redemption. In such a situation the bondholder (either in case of maturity or on call) has no option of retaining his investment or of parting with it. Regardless of how much he might wish to retain it, the redemption is entirely involuntary on the part of the holder, and it is clear that Congress could do nothing to encourage holders to redeem their bonds, because the redemption was not a matter within their control. The benefit of the statute should be limited to those who are in a position to cooperate with the legislative policy, and "sale or exchange" should be limited to its ordinary meaning and not extended to include redemption.

The rule of construction that a relief statute should be liberally construed to effectuate its purpose is not applicable when the question is whether the taxpayer is within the class intended to be relieved. It is, of course, well settled that one claiming an exemption from tax must bring himself squarely within the provisions of the statute under which he claims such exemption, and that rule is

equally applicable to a taxpayer who claims the benefit of exceptional treatment. *Bowers v. Lawyers Mortgage Co.*, 285 U. S. 182, 187. The same principle is applicable in analogous situations where statutory deductions are provided. *New Colonial Co. v. Helvering*, 292 U. S. 435, 440. The question here is whether the taxpayer disposed of his property in a transaction for which Congress offered a reward in the form of a reduction in rates. We submit that any doubt that the taxpayer is within the favored class must be resolved against him because in such cases "nothing is to be taken by inference or implication." *Riverdale Co-op. Creamery Ass'n v. Commissioner*, 48 F. (2d) 711, 713 (C. C. A. 9th).

From the foregoing discussion we think it plainly appears that it is the petitioner rather than the Government who must rely upon a technical and uncommon construction of the statute to support his position. The ordinary meaning of "redemption" is something different from that of a sale or exchange; its most common meaning is "to receive back by paying what is due"; specifically, it does not mean to "buy" or sell. Words and Phrases (2nd Series), Vol. IV, p. 220; Webster's International Dictionary. Cf. *Williamson v. Berry*, 8 How. 495, 544.

Nor do other provisions of the statute give force to the contention that Congress intended to include "redemption" within the phrase "sale or exchange." On the contrary, they indicate otherwise.

Section 204 of the statute provides the basis for determining gain or loss from the "sale or other disposition" of property, while Section 208 is limited to the gain derived from the "sale or exchange" of property. The latter phrase is clearly more limited than the former. "Redemption" and "sale" are not synonymous, and the tax result is entirely different in one case from that in the other. Even if the amount received on a redemption of bonds issued by a state would be exempt from the federal income tax, that exemption would not apply to a sale or exchange of the bonds. *Willcuts v. Bunn*, 282 U. S. 216.

Similarly, under the reorganization provisions of the statute dealing with "sales" and "exchanges" (Sections 203 and 112 of the Revenue Acts of 1926 and 1928, respectively), redemption by a corporation of its own securities can not properly be regarded as property "acquired"; the securities are merely extinguished. *Helvering v. Schoellkopf*, 100 F. (2d) 415 (C. C. A. 2d). See also *E. R. Squibb & Sons v. Helvering*, 98 F. (2d) 69 (C. C. A. 2d).

Giving effect to the plain language of the pertinent provisions, as well as their obvious purpose, we submit the statutory phrase "sale or exchange" may not reasonably be expanded to include "redemptions," as contended by petitioner. Manifestly, even a resort to the legislative history of the original provision negatives the contrary view

since the purpose was to encourage that class of investors who were in a position to take advantage of a reduction in rate by voluntary disposition of their property. Holders of bonds that are called or have matured are not in such a position.

III

THE CONSISTENT ADMINISTRATIVE INTERPRETATION OF THE STATUTE SUPPORTS THE CONSTRUCTION ADOPTED BELOW

As heretofore pointed out, the statute was first included in the Revenue Act of 1921. Article 1651 of Treasury Regulations promulgated thereunder, *infra*, provided that "gain" was taxable gain from the sale or exchange of capital assets only; gain upon redemption of bonds was not included therein. The regulations under the subsequent revenue acts to and including 1928 (see Appendix) were substantially identical and did not construe the similar provision to include redemptions. During three re-enactments (1924, 1926, and 1928) of the original provision there was thus a consistent administrative interpretation of the same statutory language and this, we submit, is entitled to great weight as showing the legislative intent. See *Helvering v. R. J. Reynolds Tobacco Co.*, No. 328, decided January 30, 1939; *Helvering v. Minnesota Tea Co.*, 296 U. S. 378; *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488; *Brewster v. Gage*, 280 U. S. 327.

Not until 1929 was there a change in the administrative interpretation and such change followed from the decision of the Board of Tax Appeals in the case of *Werner v. Commissioner*, 15 B. T. A. 482, decided February 19, 1929, in which the Board held that a redemption of bonds was a "sale or exchange" thereof within the meaning of Section 206, Revenue Act of 1921. See I. T. 2488, VIII-2 Cum. Bull. 127 (1929), Appendix, *infra*. But the conclusion reached in the *Werner* case, we submit, is not justified by the legislative history of Section 206 recited therein.

Moreover, in 1932 the Board of Tax Appeals in the case of *Watson v. Commissioner*, 27 B. T. A. 463, reconsidered and expressly overruled its former decision in the *Werner* case, *supra*. The Commissioner of Internal Revenue promptly revoked the position taken, I. T. 2488, *infra*, and readopted the uniform interpretation which he had followed from 1921 to 1929. In the *Watson* case the Board held (p. 465):

On further consideration we are of the opinion that the Board erred in its holding in *Henry P. Werner, supra*. It is elemental that where a statute is clear and unambiguous in its terms and provisions, resort should not be had to legislative history to determine the limits of its compass. The statute in question is so simple in construction and so clear in meaning that it justifies no resort to the Congressional Committee's reports as an aid in the interpretation thereof.

Such conclusion, we think, clearly is the correct view, and subsequently has been followed by the Board in its decisions. See *Braun v. Commissioner*, 29 B. T. A. 1161; *Rands v. Commissioner*, 34 B. T. A. 1107; *Brown v. Commissioner*, 36 B. T. A. 178. See also *Hale v. Helvering*, 85 F. (2d) 819 (App. D. C.); *Felin v. Kyle*, 22 F. Supp. 556 (E. D. Pa.).

IV

A CHANGE OF THE LAW WAS NECESSARY TO INCLUDE SUMS RECEIVED FROM THE REDEMPTION OF BONDS IN CAPITAL GAIN

By Section 117 (f), Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C., Title 26, Sec. 101), Congress added to the capital gain provisions a section specifically providing that amounts received by the holder upon the retirement of bonds "shall be considered as amounts received in exchange therefor." The enactment is as follows:

SEC. 117. * * *

(f) *Retirement of Bonds, etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

The reason for the change is not explained in the Senate or House Committee Reports relating to the alterations made in the capital gains law by the Revenue Act of 1934. The change apparently followed a recommendation made by the Committee on Federal Taxation of the American Bar Association (Pet. Br. 24-25), which recommended during the hearings upon the 1934 Act that Congress redefine the term "capital gain" to include redemptions.

It is interesting to note that nowhere in the provision as enacted nor by reference in committee does it appear that Congress regarded the new provision as interpretative of the prior acts. It is established that in such a situation "nothing is to be taken by inference or implication." *Riverdale Co-op. Creamery Ass'n v. Commissioner*, 48 F. (2d) 711, 713 (C. C. A. 9th); *Shwab v. Doyle*, 258 U. S. 529, 536.

The contention of the petitioner that such change is only a clarifying or explanatory amendment of the existing law is wholly without support under applicable rules of statutory construction. The controlling principle in such a situation was stated by this Court in *Russell v. United States*, 278 U. S. 181, 188:

The changes introduced into the Act of 1926 can not authorize construction of the earlier one not consonant with the language there employed.

Again, in a situation completely analogous to that here presented, where Congress in equally plain language had changed the previously existing law with reference to the right to charge off and deduct a portion of a debt, this Court said in *Spring City Co. v. Commissioner*, 292 U. S. 182, 187:

We think that the fair import of this provision, as contrasted with the earlier one, is that the Congress, recognizing the significance of the existing provision and its appropriate construction by the Treasury Department, deliberately intended a change in the law. *Shwab v. Doyle*, 258 U. S. 529, 536; *Russell v. United States*, 278 U. S. 181, 188.

Similarly, in the case at bar we are dealing with a statute long in effect, plain and unambiguous on its face, and the subject of long and uniform administrative interpretation. If Congress had the purpose assigned by the petitioner, it should have declared it. When it had that purpose it did declare it in similarly plain and unequivocal language. *Shwab v. Doyle*, *supra*; *E. R. Squibb & Sons v. Helvering*, *supra*; *Felin v. Kyle*, 22 F. Supp. 556.

Petitioner here (Br. 24-31) makes much of the recommendation of a Committee of the American Bar Association during the Congressional hearings on the 1934 Act. He fails to call to the attention of this Court similar attempts and recommendations of individuals as well as bar committees to have the same change made during the hearings on the 1928 Act. The same change, and in

virtually identical language, was asked of Congress six years before 1934 by the Association of the Bar of the City of New York, J. M. Murphy, Esq., and A. A. Ballantine, Esq. See House Hearings, Revenue Revision 1927-1928, 70th Cong., 1st Sess., pp. 464, 472-474, 488; Senate Hearings on H. R. 1, 70th Cong., 1st Sess., p. 297.

It thus appears that at a time prior to the decision of the Board of Tax Appeals in the *Werner* case, *supra*, and at a time when the uniform interpretation of the capital gains provisions excluded the redemption or retirement of bonds as a "sale or exchange," Congress had considered and rejected the recommendation to make such a change. Certainly, in the light of the history of these recommendations which finally culminated in the change in the 1934 Act, it does not appear that Congress during the many years prior thereto had intended that redemption or retirement of bonds should be included in capital gains, and in 1934 enacted only a clarifying provision.

On the contrary, we think it plain that if Congress had intended the new section of the 1934 Act as declarative of the existing law, it would have said so. Not only did it not do this, but specifically provided in Title I, Section 1, Revenue Act of 1934 (U. S. C., Title 26, Sec. 1), that "The provisions of this title shall apply only to taxable years beginning after December 31, '933." Moreover, any declaration of a possible retroactive effect with

respect to an earlier law must be "clear, strong, and imperative," as pointed out in *Shwab v. Doyle*, 258 U. S. 529, 536. See *United States v. Heth*, 3 Cranch 399, 413. "But no aid could possibly be derived from the legislative history of another act passed nearly six years after the one in question." *Penn Mutual Co. v. Lederer*, 252 U. S. 523, 538. See also: *Caminetti v. United States*, 242 U. S. 470, 490; *Smietanka v. First Trust & Savings Bank*, 257 U. S. 602, 607; *United States v. Field*, 255 U. S. 257, 264. And, in any event, the recommendation of the American Bar Association Committee at the 1934 hearings was not that Congress *clarify* the prior acts, but that it "redefine" the terms "capital gain" and "capital loss," and proposed an amendment adding the word "redemption" to "sale or exchange."

Certainly no plain purpose to change the status of cases arising under the earlier acts can be spelled out of the words in Section 117 (f), *supra*, or otherwise. The rule above quoted from *Russell v. United States* accordingly is applicable and precludes the interpretation of the section advanced by petitioner.

The decision of the First Circuit Court of Appeals in *Averill v. Commissioner*, *supra*, like that of the Board in the early *Werner* case, *supra*, disregards fundamental rules of statutory construction plainly controlling in the premises here. The court below, we submit, was eminently correct in

its observation as to the effect of Section 117 (f) when it said "If such intent had existed prior to 1934, it could and, we think, would have found similar expression" (R. 137).

CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted.

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FEBRUARY 1939.

APPENDIX

Treasury Regulations 69, promulgated under the Revenue Act of 1926:

ART. 1651. *Definition and illustration of capital net gain.*

* * * * *

"Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. * * *

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 501. *Definition and illustration of capital net gain.*

* * * * *

"Capital gain" is taxable gain from the sale or exchange of capital assets consummated after December 31, 1921. * * *

Treasury Regulations 62 and 65:

[Inasmuch as Articles 1651 of Treasury Regulations 62 and 65, promulgated, respectively, under the Revenue Acts of 1921 and 1924, are identical in all material respects with Articles 1651 and 501 of Regulations 69 and 74 above quoted, they are not set forth separately.]

I. T. 1637, II-1 Cum. Bull. 36 (1923):

REVENUE ACT OF 1921

Noninterest-bearing obligations of a political subdivision of a State were issued at 88 and upon maturity in the latter part of

1923 a taxable profit of 6x dollars will be realized by the holder, not the original purchaser. Inasmuch as the obligations have been held for over two years, inquiry is made whether the taxpayer will be subject to a tax on the capital net gain derived therefrom at the rate of $12\frac{1}{2}$ per cent.

Section 206 of the Revenue Act of 1921 reads in part as follows:

(a) That for the purpose of this title:

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

When an obligation matures it is neither sold nor exchanged. Any taxable profit derived upon maturity of a noninterest-bearing obligation is, therefore, not "capital gain" derived from the sale or exchange of capital assets and section 206 does not apply.

I. T. 2488, VIII-2 Cum. Bull. 127 (1929):

REVENUE ACTS OF 1921, 1924, 1926, AND 1928

The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed as a capital net gain under the provisions of section 206 of the Revenue Act of 1921. I. T. 1637 (C. B. II-1, 36) revoked.

Likewise, any individual who has held stock in a corporation for more than two years and who derives a gain when the stock is "called in" may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

The foregoing ruling is also applicable under the Revenue Acts of 1924, 1926, and 1928.

A ruling is requested as to the manner in which the gain from bonds or stock held for more than two years should be treated where the bonds are redeemed before their maturity date or the stock is "called in."

Under the provisions of section 206 of the Revenue Act of 1921, any taxpayer (other than a corporation) who for any taxable year derives a capital net gain may elect to be taxed on such capital net gain at the rate of $12\frac{1}{2}$ percent in lieu of the tax he would otherwise pay on such income under sections 210 and 211. Section 206 of the Revenue Act of 1921 reads in part as follows:

(a) That for the purpose of this title:

(1) The term "capital gain" means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.

In I. T. 1637 it was held that when an obligation matures it is neither sold nor exchanged. It was further held that any taxable profit derived upon maturity of an obligation is therefore not "capital gain" derived from the sale or exchange of capital assets and section 206 does not apply.

Under date of February 19, 1929, the United States Board of Tax Appeals decided, in the case of Henry P. Werner (15 B. T. A., 482, see on page 56), that the redemption of bonds at a "called" date for an amount in excess of the cost of the bonds to the bondholder results in a gain from the sale or exchange of capital assets within the meaning of section 206 of the Revenue Act of 1921. In the decision the legislative his-

tory of section 206 of the Revenue Act of 1921 was reviewed. It was stated that the Ways and Means Committee of the House and the Finance Committee of the Senate declared that the provision was intended to be applicable to the "sale or other disposition of capital assets."

The ruling contained in I. T. 1637 is hereby revoked. The net gain from bonds held for more than two years, whether received as the result of the maturity of the bonds or as the result of their redemption before maturity, may, at the option of a taxpayer other than a corporation, be taxed under the provisions of section 206 of the Revenue Act of 1921.

Likewise, any individual who has held stock in a corporation for more than two years and who derived a gain when the stock is "called in" may elect to have such gain taxed as a capital net gain in the manner and subject to the conditions prescribed in section 206 of the Revenue Act of 1921.

As the provisions of the Revenue Acts of 1924, 1926, and 1928 relating to capital net gains are similar to the provisions of section 206 (a) 1 of the Revenue Act of 1921, the foregoing ruling is also applicable under those Acts.

I. T. 2678, XII-1 Cum. Bull. 117 (1933):

REVENUE ACTS OF 1921, 1924, 1926, AND 1928

I. T. 2488 (C. B. VIII-2, 127), which holds that the gain derived from stock of a corporation "called in," or the gain derived from bonds as the result of their maturity or redemption before maturity, where such stock or bonds have been held for more than two years, may be taxed as a capital net

gain, is revoked, in so far as inconsistent with the decision of the Board of Tax Appeals in *John H. Watson, jr., v. Commissioner* (27 B. T. A., 463, page 13, this Bulletin).

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CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

October Term, 1938

No. 65

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

*On Writ of Certiorari to the United States Circuit
Court of Appeals for the Ninth Circuit.*

**MOTION AND BRIEF OF CARROLL N. PERKINS AND
LEONARD A. PIERCE AS AMICI CURIAE FOR AND
ON BEHALF OF FRANCES M. AVERILL**

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Supreme Court of the United States

October Term, 1938

No. 65

DOUGLAS FAIRBANKS,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

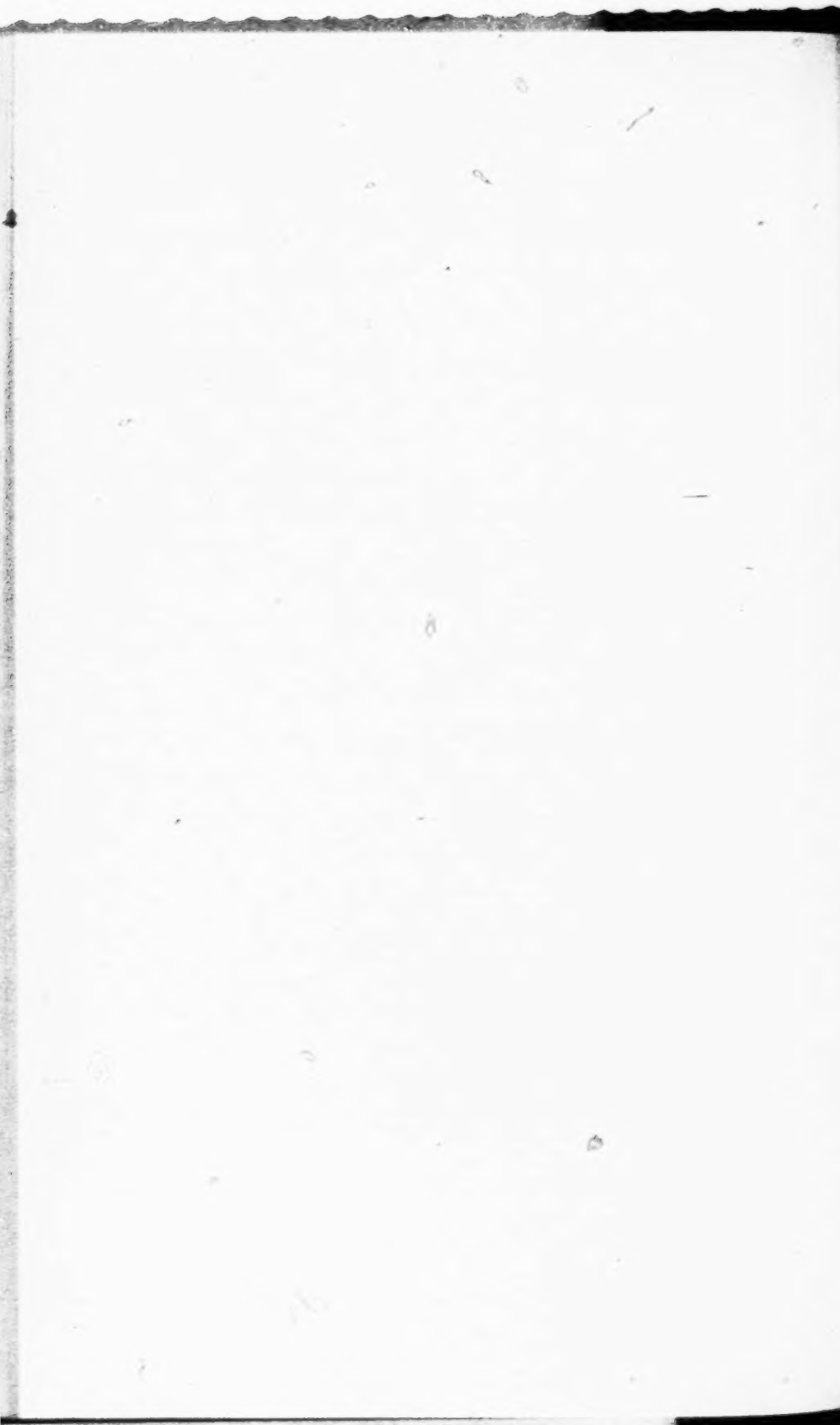
May It Please The Court :

The undersigned as counsel for Frances M. Averill, respectfully move this Honorable Court for leave to file the accompanying brief in this case as *amici curiae*.

CARROLL N. PERKINS,

LEONARD A. PIERCE,

Counsel for Frances M. Averill,
Amici Curiae.



Supreme Court of the United States

October Term, 1938

No. 65

<p>DOUGLAS FAIRBANKS, <i>Petitioner,</i> against UNITED STATES OF AMERICA, <i>Respondent.</i></p>

*On Certiorari To The Circuit Court of
Appeals for the Ninth Circuit.*

BRIEF OF AMICI CURIAE.

This brief, by permission of the Court and with the consent of counsel for the respective parties, is filed by the undersigned as *amici curiae*, and on behalf of Frances M. Averill of Waterville, Maine, the Petitioner in *Averill v. Commissioner*, decided by the Circuit Court of Appeals for the First Circuit on December 28, 1938, by reason of which decision this Court granted *certiorari* in the case at bar.

We also represent her husband, George G. Averill, the Petitioner in other cases pending before the Circuit Court of Appeals for the First Circuit, in all of which the question here presented is involved.

FACTS.

The facts in the case in suit are set out in the transcript of record and in the opinion of the Circuit Court of Appeals for the Ninth Circuit, as well as in the brief of the Petitioner.

A BRIEF RESUME OF THE FACTS IN THE CASE REPRESENTED BY THE UNDERSIGNED DECIDED BY THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

Frances M. Averill, a resident of Waterville, Maine, had owned for more than two years \$85,000. principal amount of the mortgage bonds of Keyes Fibre Company, Inc. when on September 1, 1931 they matured and were paid in accordance with the terms of the indenture under which they were issued.

Omitting other contentions not involved in the case at bar, as to which the Circuit Court of Appeals for the First Circuit ruled in favor of the taxpayer, the taxpayer contended and that Court found, in direct opposition to the decision of the Circuit Court of Appeals for the Ninth Circuit, that the taxpayer was entitled to the benefit of the Capital Gains Section, so called, and thus the profit received on the payment of her bonds at maturity was taxable at the maximum rate of 12½%. The only factual differences between the cases are: in that at bar the gains were received in the years 1927, 1928 and 1929, in our case they were received in the year 1931. In the case at bar the bonds were called for payment prior to maturity. In our case they were paid at the maturity named in the bonds.

One of the questions decided by the Circuit Court of Appeals for the First Circuit in our case, *Averill v. Commissioner*, C. C. A. (First Circuit, October Term, 1938, #3376) is the very question presented to this Court in the instant case, although the decision in the *Averill* case was also based upon other grounds, likewise equally conclusive. The amount involved in the case decided by the First Circuit, together with the three other pending cases in which our clients are interested, involving the payment of other maturities of the same issue in 1932 and 1933, is somewhat in excess of \$100,000. For these reasons our clients have a very real interest in the decision of this case.

THE ISSUE.

The issue presented in the case in suit, while narrow, is nevertheless important: Do the words "sale or exchange" in Section 208 (a) (1)¹ of the Revenue Act of 1926 and the identical words in Section 101 (c) (1) of the Revenue Act of 1928 include the payment of bonds by the issuing corporation?

I.

WHETHER OR NOT THE LITERAL WORDING OF THE SECTION WOULD ORDINARILY INCLUDE PAYMENT, EITHER AT MATURITY OR ON CALL, SUCH PAYMENT IS CLEARLY WITHIN THE CONGRESSIONAL INTENT.

It is axiomatic that the ultimate goal to be sought in the expounding of statutes, either state or federal, is the intention of the legislative body enacting them. The literal meaning of the words used is of course important, but even such literal meaning must be subservient to the legislative intent when such intent can be clearly ascertained.

¹"(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921;"

Instances in which courts of high standing have felt justified in going beyond the literal wording of a statute in order to determine the legislative intent could be multiplied indefinitely,² particularly when, as here, the literal meaning leads to an obviously unfair result. In *Lionberger v. Rouse*, 9 Wallace 468, this Court said at page 475:

“ * * * * It is a universal rule in the exposition of statutes that the intent of the law, if it can be clearly ascertained, shall prevail over the letter, and this is especially true where the precise words, if construed in their ordinary sense, *would lead to manifest injustice.*” (Emphasis supplied.)

One becomes impressed with the antiquity of this principle from the quaint language in the case of *Stradling v. Morgan*, Plowden 205a, as quoted with approval in *Cox v. Hakes*, 15 App. Cas. 506, at p. 518 (1890):

“From which cases it appears that the sages of the law heretofore have construed statutes quite contrary to the letter in some appearance, and those statutes which comprehend all things in the letter, they have expounded to extend but to some things, and those which generally prohibit all people from doing such an act, they have interpreted to permit some people to do it, and those which include every person in the letter they have adjudged to reach to some persons only, which expositions have always been founded on the intent of the Legislature, which they have collected sometimes by considering the cause and necessity of making the Act, sometimes by comparing one part of the Act with another, and sometimes by foreign circumstances. *So that they have ever been guided by the intent of the Legislature.*”

² In *Hawaii v. Mankichi*, 190 U. S. 197 (1903), the Court stated at page 213: “ * * * * the books are full of authorities to the effect that the intention of the lawmaking power will prevail, even against the letter of the statute, * * * * ”

which they have always taken according to the necessity of the matter and according to that which is consonant to reason and good discretion." (Emphasis supplied.)

We know of no clearer judicial exposition of this principle than that stated by this Court in *Helvering v. New York Trust Co.*, 292 U. S. 455 (1934), wherein the Court said (p. 464) :

"But the expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished.

* * * * *

Quite recently in *Ozawa v. United States*, 260 U. S. 178, 67 L. Ed. 199, 43 S. Ct. 65, we said (p. 194) : 'It is the duty of this court to give effect to the intent of Congress. Primarily this intent is ascertained by giving the words their natural signifiacnce, but if this leads to an unreasonable result, plainly at variance with the policy of the legislation as a whole, we must examine the matter further. We may then look to the reason of the enactment, and inquire into its antecedent history, and give it effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail.'

Applying to the legislation involved in the case at bar every test thus prescribed by this Court, we find that the result of each such test is consistent only with the taxpayer's position and entirely inconsistent with that of the Department.

Thus, granting for the purposes of argument that the literal meaning of the words would exclude payment, as the Government contends, we find that such construction

would (1) "lead to an unreasonable result", and (2) be "plainly at variance with the policy of the legislation as a whole".

(A) The construction urged by the Government leads "to an unreasonable result".

Instances of the unreasonable result to which the construction urged by the Government would lead are numerous. If a taxpayer sells one-half his bonds only one day prior to the date of payment but retains the other half and presents them in normal course on the due date, he would be taxable at a much higher rate for those he held a day longer and at a much lower rate for those sold the day before.³ If taxpayer A, owning certain bonds of an issue, presents them at maturity for payment he is taxable at a higher rate, while taxpayer B, who has happened to sell his bonds prior to maturity at par, is taxable at a lower rate. If a taxpayer sells his bonds to the issuing corporation a few days before maturity he is taxed at the lower rate, if he presents them at maturity, at the higher rate. If a corporation elects to call its bonds and the taxpayer awaits the due date fixed by the call he is taxable at the higher rate, while if the corporation, instead of calling had followed the not unusual course of purchasing its own bonds on the open market from their holders, the tax would be at the lower rate. If the securities called for payment are preferred stock the tax is at the lower rate.⁴ If, on the other hand, bonds are called the tax is at the higher rate.

Turning then to *Ozawa v. U. S.*, 260 U. S. 455, quoted supra, if the "natural significance" of the language of the Act be in accord with the Government's contention, no one could fairly

³ *McKee et als. v. Commissioner*, Dec. No. 9547 (C. C. H. 1937).

⁴ *Mary S. Childs v. Commissioner*, Dec. No. 9653 (C. C. H. 1937).
Robert I. Meyer, 27 B. T. A. 44 (Dec. No. 7810).
Louis Rorimer, 27 B. T. A. 371 (Dec. No. 7953).

claim that such "natural significance" did not "lead to an unreasonable result". In fact, the result is not only unreasonable; it lacks any semblance of fairness.

(B) Applying the second test stated in the Oxawa case, the result of the Government's contention is "plainly at variance with the policy of the legislation as a whole".

That policy has been clearly and authoritatively stated by this Court in *Burnet v. Harmel*, 287 U. S. 103, at 106, when in construing the 1924 Act (identical in phraseology with the 1926 and 1928 Acts) the Court said:

"* * * * * The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

We submit that the Circuit Court of Appeals for the Ninth Circuit, in its opinion in the pending case, for no apparent reason disregarded the first of the two purposes which this Court in the above quoted paragraph plainly found were intended by the Act in question.

Not only does the Government disregard the first of the reasons stated by this Court for the enactment of the Capital Gains Section, but it also ignores the limitation contained in the Section itself. Were Congress interested only in the gain to the revenue, there would be no good reason for the provision in the section that only gains on assets held for more than two years come within the Section. The revenue would be still further increased if the limitation to assets held more

than two years were omitted. The inclusion of such limitation proves this Court correct in saying that Congress intended not only to increase the revenue but "to relieve the taxpayer from these excessive tax burdens". We submit the Ninth Circuit erred in finding the contrary.

It would therefore seem clear that in construing the Capital Gains Section and giving it "*effect in accordance with its design and purpose, sacrificing, if necessary, the literal meaning in order that the purpose may not fail*", the taxpayer in the case at bar is entitled to treat the payment of his bonds when called by the issuing corporation as a "sale or exchange" of a capital asset.

II.

AN AMBIGUITY EXISTS IN THE WORDING OF THE SECTION, TO RESOLVE WHICH TWO WELL RECOGNIZED CANONS OF STATUTORY CONSTRUCTION SHOULD BE APPLIED.

In answer to the Government's argument that "sale or exchange" are unambiguous terms, do not include payment and therefore there is no room for construction, the Circuit Court of Appeals for the First Circuit (*Arerill v. Commissioner, supra*) pointed out that it is not true "that in the very nature of things a covenantor cannot sell a bond or other specialty to the covenantor". The holder can sell a bond to anybody. The incidents of such sales may vary and the purchaser, if a stranger, not only gets title to the bond but the right to enforce it. The covenantor, however, having acquired the bond at maturity or on call, gets title to the bond exactly as would the stranger, even though he acquires no right to enforce it. A bond, a piece of paper, as distinguished from the rights which accrue to the holder, can be the subject of

larceny in every state in the Union.⁵ In states which retain the common law procedure, the action of trover, which in its essence is based upon the right to possession of tangible personalty, can unquestionably be maintained for the conversion of a bond or a note.⁶ The measure of damages may vary, it is true, under the circumstances of the particular case, but the fact is unquestioned that the physical document has all the characteristics of tangible personalty, separate and distinct from those of a chose in action.

This being so, there can be no good reason why the surrender of the bond to the issuing corporation on payment therefor should not be deemed an exchange of the bond itself. Immediately prior to the surrender the bondholder had title not only to the chose in action but title also to the document. After the surrender the covenantor had title to the document and the bondholder title to the money. Accurately and literally, there was an "exchange" of bond for money and the transaction did not lose the character of an "exchange" because it was also the payment of a chose in action. We appreciate that title to the piece of paper and the incidents of such title are usually not so important as title to the chose in action and its incidents. On the other hand, the Government insists on an interpretation of the statute which no one pretends to say is fair or that Congress would have intended, if it had chanced to consider the effect of the language used, when a capital asset was paid in due course. The language of Judge Hand in *Freedman Bros. v. Greaney*, 297 Fed. 478, 479, is an appropriate answer to the Government's position: "If the defendant would chop logic, I may insist that he chop through to the end. * * * The defendant must take the bitter with the sweet."

The drafting of a general statute, to cover a multiplicity of transactions later to transpire, is always fraught with danger

⁵ 34 C. J. 742, Sec. 27.

⁶ *Chew v. Louchheim*, 89 Fed. 500 (1897), (C. C. A. 3d).

Kimball v. Billings, 55 Me. 147 (1867).

that the general language used at the time may not exactly fit into a perfectly normal future transaction, to which the attention of the draftsman was not at the time specifically called. As this Court said in *Helvering v. New York Trust Company, supra*, (at p. 465) :

"Construed strictly according to the letter, the provision would not include shares received as a dividend less than two years before the sale or property taken in exchange within that period. The need of this regulation illustrates how ambiguities requiring construction often exist where upon first reading the words seem clear. Generally, questions as to the meaning intended do not arise until the language used is compared with the facts or transactions in respect of which the intent and purpose are to be ascertained."

* * * * *

The meaning of the statute, then, as the Circuit Court of Appeals for the First Circuit said in the *Averill* case, being "debatable", we turn to recognized canons of construction to aid in its interpretation.

- A. *Congress, by re-enacting the Capital Gains Section without change, subsequent to the decision in the Werner case and to the administrative ruling acquiescing in that decision, adopted the interpretation therein set forth, and such interpretation is controlling as to the 1926, 1928 and all subsequent Acts.*

As pointed out in the brief for the Petitioner, on February 19, 1929, the Board of Tax Appeals decided this very question by unanimous decision in accord with our contention. On the announcement of that decision the Commissioner revoked his previous ruling and, as to the Acts of 1921, 1924, 1926 and 1928, directed that the net gain from bonds derived

as a result of their payment at, or redemption on call before, maturity should, at the option of the taxpayer other than a corporation, be taxed under the Capital Gains Section. Thus, from February, 1929, until December, 1932, when the *Watson* case was decided, or for almost four years, the ruling of the administrative department of the Government in charge of the collection of income taxes and, what seems to us of even more importance, the ruling of the Board especially established by Congress to determine questions arising under the Revenue Acts, interpreted these statutes in accordance with our contention. In the interim Congress had re-enacted the section using the identical phraseology adjudicated in the *Werner* case and found in the prior Acts.

There is no rule of statutory construction better established in this and other Courts than that such re-enactment by the legislative branch is an adoption of the interpretation theretofore placed upon the language by the administrative or quasi-judicial branches especially charged with its enforcement. See *United States v. Bassichis Co. et al*, 16 Customs Appeal 410, in which case the Court said:

"In T. D. 19311 there was a definite, clear interpretation of the words 'all glass—not specially provided for,' which when unappealed from, became the definitely determined judicial status of the question, to be followed in the administration of the tariff act. After that decision was rendered and promulgated, Congress, on three successive occasions, used the identical language and it must be presumed that in using it the legislative body was fully cognizant of such judicial interpretation and the results that would ordinarily flow from it."

In the recent case of *Hassett v. Welch*, 303 U. S. 303, decided by this Court on February 28, 1938, the Collector of Internal Revenue sought to tax as part of a gross estate a certain amount of money irrevocably granted in trust, with

the reservation of life income to the trustor, before the Joint Resolution taxing such transfers was passed. This Court ruled against the Collector, holding that the Act was not intended to be retroactive. The Secretary of the Treasury on May 22, 1931, had issued a letter of directions that the relevant section be construed prospectively only. Congress had then re-enacted the substance of the Joint Resolution in the Act of 1932. In its opinion at page 312 this Court said:

"Moreover, the re-enactment of the Resolution of 1931 in the light of the administrative rulings requires the conclusion that Congress approved and adopted the administrative constructions of the provision it re-enacted."

Nor is this principle limited to the construction of Acts re-enacting the prior statute in the same words and passed subsequent to the administrative rulings. It applies with like effect to the acts under which the rulings were promulgated.

Buttolph v. Commissioner, 29 Fed. 2nd 695, C. C. A. 7th Cir. 1928, was a case arising under the Income Tax Act of 1922. Administrative rulings had been promulgated under that Act and then in 1924 and in 1928 the section was re-enacted. The Court said (p. 696) :

"Such re-enactment of a statute, after practical construction—not plainly erroneous—and specific operation under it, may presumably be construed to embody such construction as a satisfactory interpretation of the legislative intent."

We would particularly call the Court's attention to the case of *Brewster v. Gage*, 280 U. S. 327. The petitioner, one of the residuary legatees of an estate, in the years 1920, 1921 and 1922 sold certain stocks distributed to him in 1920 and computed the profit or loss on each sale by comparison of its selling price with the value at the date of distribution. The applicable statutes,—that of 1918 as to 1920 income and that of 1921 as to 1921 and 1922 income,—provided that the basis

should be the fair market price or value "when acquired" (1918) or at the "time of acquisition" (1921). Literally interpreted, there could be no question that the residuary legatee "acquired" title at the date of distribution rather than on the date of the death of the testator, even though the legal title might relate back to the date of death. On the other hand, unquestionably real estate and specific bequests would vest at the time of death and there was no real reason why gains or losses to the estate or to specific devisees or legatees should be calculated on one basis and those to the residuary legatees on another. In its opinion deciding that date of death controlled under both Acts this Court stressed the regulations of the Commissioner under the 1918 Act and that the Act of 1921 was substantially identical with the 1918, and said (pages 336, 337) :

"It is the settled rule that the practical interpretation of an ambiguous or doubtful statute that has been acted upon by officials charged with its administration will not be disturbed except for weighty reasons. * * * The substantial re-enactment in later acts of the provisions theretofore construed by the department is persuasive evidence of legislative approval of the regulation. * * * *The subsequent legislation confirmed and carried forward the policy evidenced by the earlier enactments as interpreted in the regulations promulgated under them.*" (Emphasis supplied.)

Applying this decision to the case at bar the re-enactment of the section in 1932 is an adoption of the *Werner* case, not only as to cases under the 1932 Act but as to all previous acts in which the Capital Gains Section is found.

The ruling of these cases is in entire accord with that set out by Chief Justice Marshall in *Alexander v. Alexandria*, 5 Cranch 1. When a number of statutes, whenever passed, relate to the same thing or general subject matter, they are to be construed together and are *in pari materia*.

Thus, whatever possible occasion for doubt there may have been prior to the enactment of the 1932 Act, the re-enactment of the section in that year, after the decision of the *Werner* case and the acquiescence of the Department, constituted a legislative approval of the rule therein set forth. When the Board on December 29, 1932, in *Watson v. Commissioner*, reversed its prior decision in the *Werner* case, it disregarded entirely the fact that earlier in the same year, in accordance with the principle above referred to, Congress had approved the ruling of the *Werner* case as a settled interpretation of the words used.

This conclusion is strengthened when we note that in May, 1934, in the Revenue Act next following the Board's overruling of *Werner v. Commissioner*, Congress added to the Capital Gains Section a decisive interpretation of the word "exchange" exactly in accord with the *Werner* decision.

It is difficult to find a clearer indication of the will of Congress. The original act is passed. The authorities especially established to administer it and to pass upon it judicially, the Commissioner and the Board, agree upon the interpretation for which we contend. Congress then re-enacts the section in identical words. The Board then erroneously reverses itself. But, at the very next opportunity, Congress adds a specific subsection to the Act giving to the words used the identical effect found in the *Werner* case, so that thereafter there will be no room for further argument.

- B. *The interpretation of the word "exchange", added to the Capital Gains Section in 1934, constitutes a legislative declaration of its meaning and governs the construction of the capital gains provision from its first enactment in 1921.***

In May, 1934, Congress added to the Capital Gains Section under controversy this subsection:

"(f) *Retirement of bonds, etc.* For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. . . . c. 277, Sec. 117, 48 Stat. 714.)" (26 U. S. C. A. Sec. 101, page 427.)

The Court will note the form of this amendment. Instead of amending subsection (c) of the 1928 Act in any way, Congress specifically provided that the amounts received in payment of bonds should be considered as amounts "received in exchange therefor". Congress was thus not changing the prior law but merely enacting a definition to be read into the law; such definition being necessitated by the decision in the *Watson* case which conflicted with the Congressional intent.

The brief for the Petitioner in the instant case fully covers this point and it would seem unnecessary for us to elaborate more fully thereon. We are unable to see any reason why the case at bar does not come squarely within the principle laid down by Chief Justice Marshall in *Alexander v. Alexandria*, 5 Cranch 1. The mere form of the amendment itself shows clearly that subsection (f) was not a declaration of a new policy but, as this Court said in *Jordan v. Roche*, 228 U. S. 436, "a more explicit expression of the purposes of the prior law made necessary by the judicial construction of that law", viz. the decision of the Board in the *Watson* case.

The case of *Felin v. Kyle*, 22 Fed. Supp. 556, cited and relied upon by the Government in the Circuit Court of Appeals for the First Circuit is illustrative of the erroneous interpretation which the Government places upon the 1934 legislation. In that case the District Court ruled that the 1934 amendment, passed after the decision of the *Watson*

case, showed clearly that Congress intended by the new provision to change the prior rule. Respectfully we submit that the decision of this Court in *Jordan v. Roche*, *supra*, is an apt illustration of the correct view and is diametrically opposed to the ruling in *Felin v. Kyle*, *supra*, and to the Government's contention here.

The facts in *Jordan v. Roche* show that in the years 1907 and 1908 the plaintiff imported from Porto Rico certain casks of bay rum. At that time the controlling Act was that of 1900 under which the Treasury had ruled such importation dutiable. In 1908 the Circuit Court of Appeals for the Second Circuit in *Anderson v. Newhall*, 161 Fed. 906, ruled adversely to the Government. For a few months thereafter the revenue officers followed the ruling of that case. On February 4, 1909, Congress passed an act specifically providing for taxation of bay rum in accordance with the prior interpretation by the Revenue Department and exactly contrary to the decision in *Anderson v. Newhall*, *supra*. The importer contended that the passage of the 1909 Act was a declaration that bay rum had not been subject to a tax under the prior statutes. Replying to that contention this Court said (228 U. S. at 445, 446) :

“ * * * The history of the act rejects the contention and manifests that the act was passed in consequence of the decision in *Newhall v. Anderson*, and the other decisions to which we have referred. *The law was not the declaration of a new policy but a more explicit expression of the purpose of the prior law, made necessary by the judicial construction of that law.*” (Emphasis supplied.)

It would be difficult to find a more exact parallel to that in the case at bar than the situation in *Jordan v. Roche*. In that case the Revenue Act was being properly construed until the erroneous decision of *Newhall v. Anderson*. There-

upon Congress by the 1909 legislation enacted "a more explicit expression of the purpose of the prior law". In our situation the Capital Gains Section had been properly construed in the *Werner* case and was being properly administered until the erroneous decision of the *Watson* case. In the next Revenue Act, the hearings for which began almost immediately after that decision, Congress specifically adopted the ruling of the *Werner* case and repudiated that of the *Watson*.

It is interesting to note that in an elaborate opinion by Judge Stephens of the Circuit Court of Appeals for the Ninth Circuit in *Santa Monica Etc. v. U. S.*, 99 Fed. 2d 450 (October, 1938) the very Court whose action is here sought to be reviewed has emphatically approved the two rules of statutory construction upon which we rely.

On page 456 of the opinion we find the following language:

"* * * That such was a proper interpretation of section 234 (a) (5) is emphasized by the fact that Congress thrice re-enacted the section as found in the Revenue Act of 1921 in its identical language *after* the quoted Regulations had been promulgated. It is a settled rule of statutory interpretation that administrative construction of a statute must be deemed to have received legislative approval by re-enactment of the statutory provision without change. * * * It must be recalled that Congress amended the section in 1932, 26 U. S. C. A. Sec. 23 (k), changing the language to read * * * . We do not think that Congress in so amending intended to change the law. The new statute was merely declaratory of the meaning of the previous law and was intended as a clarification thereof."

The Court will note that the decision in *Averill v. Commissioner* by the Circuit Court of Appeals for the First Circuit was announced after the decision by the Circuit Court of Appeals for the Ninth Circuit in the case at bar and that the

Court in the later case reviewed the opinion here sought to be reversed, including the very contention we are now discussing. After careful consideration it decided that under all the circumstances the doctrine of *Alexander v. Alexandria* is here relevant and decisive. We submit that its opinion is persuasive and will commend itself to this Court.

CONCLUSION.

Mr. Fairbanks and our clients made their returns in perfectly good faith and paid the full tax of $12\frac{1}{2}\%$, or an eighth of their gain, to the Government. At no time have they shown the slightest disposition to evade their fair contribution to the Federal revenue. We as their counsel are wholly unable to follow the basic theory behind the Government's attitude to our clients or that of the decision in the Ninth Circuit. While it is undoubtedly true that taxing statutes are to be construed against the taxpayer in order to prevent exemptions, it is equally true that such statutes are to be construed so that the burden of government will fall equitably and fairly upon its citizens. Neither Congress nor the Courts intend that there shall be a distinction between the tax to be paid by one taxpayer and that to be paid by another, unless there be some reason in fairness or in logic for such distinction. In no one of the briefs filed by the Government, in no one of the decisions sustaining its position, has there appeared even a suggestion that the result which the Government seeks in these cases is by any conception fair or just or that it rests other than on a strictly literal construction of the words of the statute.

No one can gainsay that the basic principle of statutory construction is the intention of Congress and we cannot believe that there is anything in this legislation, in its history or in its practical application, which demonstrates that the Congress of the United States ever intended the distinction for which the Government here contends.

To add to the taxable income of any taxpayer in a single year a profit accrued over a series of years results, as this Court said, in "excessive tax burdens". It is a reflection on the fairness of purpose of Congress to allege, as does the Government, that it is entirely willing to allow taxpayers to suffer under "excessive tax burdens" save only when relief therefrom will result in an increase in the public revenue. It is an unveiled assertion that the Congress of the United States stands indifferent when its citizens are unfairly taxed unless, as an incident to relieving them, the governmental revenue can be increased. We cannot believe that Congress entertains towards its constituents an attitude which would intentionally penalize those who happen to hold their capital investments until payment, and yet relieve those who chance to dispose of them before maturity.

As this Court said in *Helvering v. New York Trust Company, supra*, "It is to be inferred that Congress did not intend penalization of that sort." Nevertheless, the contention of the Government in these cases, in absolute disregard of one purpose of the statute authoritatively set forth in *Burnet v. Harmel*, attempts as to these taxpayers a result which cannot be otherwise characterized.

Respectfully submitted,

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Of Counsel.

FILE COPY

FILED

JAN 16 1939

CHARLES SUMNER CHAPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1938

No. 65

65

DOUGLAS FAIRBANKS,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

**MOTION FOR LEAVE TO FILE PETITION FOR
REHEARING OF PETITION FOR CERTIORARI
AND PETITION THEREFOR.**

ARTHUR F. DRISCOLL,

Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 1069.

DOUGLAS FAIRBANKS,

Petitioner,

against

UNITED STATES OF AMERICA,

Respondent.

**MOTION FOR LEAVE TO FILE PETITION FOR REHEARING
OF PETITION FOR CERTIORARI.**

**MOTION FOR AN ORDER VACATING THE ORDER OF THIS
HONORABLE COURT DATED OCTOBER 10, 1938,
DENYING PETITION FOR A WRIT OF CERTIORARI.**

**MOTION FOR AN ORDER THAT THE ENTRY OF JUDG-
MENT IN THIS CASE BY THE DISTRICT COURT OF
THE UNITED STATES FOR THE SOUTHERN DISTRICT
OF CALIFORNIA, CENTRAL DIVISION, BE STAYED
UNTIL THE FINAL DETERMINATION OF THIS ACTION
OR UNTIL FURTHER ORDER OF THIS HONORABLE
COURT.**

NOW COMES THE PETITIONER, Douglas Fairbanks, by his counsel of record, and moves this Honorable Court for the following relief:

I. For leave to file the attached petition for rehearing of the petition for a writ of certiorari to the Circuit Court of Appeals for the Ninth Circuit.

II. For an order vacating the order of this Honorable Court, dated October 10, 1938, denying the petition for a writ of certiorari.

III. For an order that the entry of judgment in this case by the District Court of the United States for the Southern District of California, Central Division, be stayed until the final determination of this action or until further order of this Honorable Court.

On October 1st, 1938, this Honorable Court denied the petition for certiorari herein to the Ninth Circuit Court of Appeals, to review the decision of that Court, affirming a judgment of the United States District Court for the Southern District of California, Central Division, adjudging that the United States of America was entitled to recover income tax refunds alleged to have been made erroneously to Douglas Fairbanks for the calendar years 1927, 1928 and 1929 totaling \$72,186.94, together with 6% interest from the date of payment of such refunds. The question of law involved is a construction of the meaning of the words "sale or exchange" of capital assets contained in Section 208(a)(1) of the Revenue Act of 1926 and Section 101(c)(1) of the Revenue Act of 1928.

On April 2, 1938, the Circuit Court of Appeals for the Ninth Circuit in this case held that the redemption of bonds prior to maturity by an issuing corporation did not constitute a "sale or exchange" of capital assets so as to entitle the holder thereof to be taxed at the remedial rate of 12 $\frac{1}{2}$ % upon the gains.

On December 28, 1938 (opinion filed January 6, 1939), the Circuit Court of Appeals for the First Circuit, in the case of

Frances M. Averill v. Commissioner of Internal Revenue, refused to follow the Fairbanks decision and held that the payment of bonds at maturity by an issuing corporation did constitute a "sale or exchange" of capital assets and that the bondholder was entitled to the benefit of the remedial rate of 12½% on the capital gains.

The decision in the *Averill* case is in direct conflict with the decision of the Ninth Circuit Court of Appeals in the present case. In view of this conflict and for the reasons set forth in the petition for rehearing it is respectfully submitted that petitioner's motion for leave to file a petition for rehearing and for an order vacating the order of this Honorable Court, dated October 10, 1938, denying the petition for a writ of certiorari herein should be granted.

On October 18, 1938, the mandate of the United States Circuit Court of Appeals for the Ninth Circuit was issued in the present case. Thereafter counsel for the United States of America prepared a final judgment for entry by the United States District Court for the Southern District of California, Central Division, and has forwarded said judgment to counsel for petitioner for approval. The matter is now pending before the United States District Court for the Southern District of California, Central Division, for entry of such final judgment.

The collection of the taxes herein involved amounting to \$72,186.94 with interest at 6% per annum from January 26, 1932, in the sum of approximately \$30,000, making a total of \$102,186.94, is not in jeopardy for the reason that your petitioner has filed with the United States District Court for the Southern District of California, Central Division, a bond in the amount of \$100,000, the amount of the said bond having been agreed to and approved by counsel for respondent on review. In addition, Douglas Fairbanks is of sufficient means to respond amply to the amount of said judgment in excess of the bond.

Your petitioner is informed and believes that if final judgment be entered by the United-States District Court for the Southern District of California, Central Division, and collection made thereon, it will forever bar your petitioner from relief, even though this Honorable Court should subsequently reverse the decision of the Circuit Court of Appeals for the Ninth Circuit.

Pending the decision in the case of *Frances M. Averill v. Commissioner* and on December 20, 1938, your petitioner made application to the Circuit Court of Appeals for the Ninth Circuit requesting that that Court stay the entry of the judgment in the instant case until February 12, 1939, and for an order recalling the mandate of that Court heretofore issued on October 18, 1938. On December 22, 1938, the Circuit Court of Appeals for the Ninth Circuit denied petitioner's motion. Therefore, unless relief is granted by this Honorable Court, your petitioner respectfully submits that he will be forever barred from obtaining relief.

As a precedent for the within application, your petitioner respectfully relies upon the order entered by this Honorable Court in *Robert G. Stone and Carrie M. Stone, Trustees under the Will of Galen L. Stone v. Thomas W. White, Former Collector of Internal Revenue at Boston, Massachusetts*. Case No. 202, October Term, 1935.

WHEREFORE, it is prayed that the relief sought by these motions be granted.

Respectfully submitted,

ARTHUR F. DRISCOLL,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 1069.

DOUGLAS FAIRBANKS,
Petitioner,

against

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR REHEARING OF DENIAL OF PETITION FOR CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

*To the Honorable the Chief Justice and the Associate
Justices of the Supreme Court of the United States:*

COMES NOW YOUR PETITIONER, Douglas Fairbanks, and
presents this petition for a rehearing of the petition for cer-
tiorari in this case.

Jurisdiction.

The petition for certiorari in this case was filed on May 28,
1938 and the petition was denied by this Honorable Court on
October 10, 1938.

Reasons for Petition for Rehearing.

On December 28, 1938 (opinion filed January 6, 1939) the Circuit Court of Appeals for the First Circuit rendered a decision in the case of *Frances M. Averill v. Commissioner of Internal Revenue*, which is in square conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in the instant case.

In addition this case presents an important question of the law of federal income taxation which has never been passed upon by this Honorable Court. The specific questions at issue are:

1. Does the redemption of bonds by an issuing corporation before maturity constitute a *sale or exchange of capital assets* as to the owner and holder of the bonds, within the meaning of Section 208(A)(1) of the Revenue Act of 1926 and Section 101(C)(1) of the Revenue Act of 1928.

2. Does the gain realized by the bondholder constitute (a) capital gain from the sale or exchange of a capital asset taxable at the 12½% rate; or (b) ordinary income taxable at both normal and surtax rates.

In the instant case the Circuit Court of Appeals for the Ninth Circuit held that the redemption of such bonds prior to maturity did not constitute a "sale or exchange" of capital assets within the meaning of the above cited provisions of the Revenue Acts, stating in its opinion (Record, pp. 135, 136):

"By §§208(a)(1) and 101(c)(1) the term 'capital gain' is defined as meaning 'taxable gain from the sale or exchange of capital assets consummated after December 31, 1921.' It is conceded that the bonds in question were capital assets, and that they were redeemed after December 31, 1921. The question is whether such redemption constituted a 'sale or exchange' of the bonds, within the meaning of §§208(a)(1) and 101(c)(1).

"We think not. Between the *redemption* of a bond and the *sale or exchange* thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according to its terms. It is in no wise a *sale or exchange*. *Watson v. Commissioner*, 27 B.T.A. 463, 465; *Braun v. Commissioner*, 29 B.T.A. 1161, 1177."

In the *Averill* case the Circuit Court of Appeals for the First Circuit had before it for decision among other things, the question of whether the payment at maturity of bonds constituted a "sale or exchange" of capital assets within the meaning of Section 101(c) (1) of the Revenue Act of 1928, so as to afford Mrs. Averill the use of the remedial 12½% tax rate on capital gain. The *Averill* case was argued before the said First Circuit Court of Appeals after October 10, 1938 after the decision in the instant case and the decision of the Ninth Circuit Court of Appeals in the instant case was fully briefed to the Court, and the said Court was advised orally of the denial of certiorari by this Honorable Court.

The First Circuit Court of Appeals as regards the problem of taxation, refused to consider any distinction between bonds called for redemption prior to maturity and bonds paid at maturity, thus clearly indicating as had every court passing on this question, as well as the Commissioner of Internal Revenue in his rulings, that an identical legal problem is present in both instances.

See:

Henry P. Werner, 15 B.T.A. 482;
John H. Watson, Jr., 27 B.T.A. 463;
Ernest W. Brown, 36 B.T.A. 178;
Felin v. Kyle, 22 Fed. Supp. 566;
 IT 1637 II-1 C.B. 36;
 IT 2488 VIII-2 C.B. 127;
 IT 2678 XII. 1 C.B. 117.

The Circuit Court of Appeals for the First Circuit then studied the legislative history of the *capital gain and loss*

provisions of the Revenue Acts, from their original inclusion in the Revenue Act of 1921, and determined that the payment of bonds at maturity constitutes a "sale or exchange" of capital assets entitling the holder thereof to have her gains thereon taxed at the remedial rate of $12\frac{1}{2}\%$. This decision is in complete conflict with the decision of the Ninth Circuit Court of Appeals in the instant case.

For the convenience of this Honorable Court the entire opinion in the *Arcerill* case is reprinted herein as Appendix "A" and the opinion of the Ninth Circuit Court of Appeals in the instant case (95 Fed. 2d 794) is reprinted herein as Appendix "B".

In addition to the above reasons for rehearing, your petitioner respectfully refers this Honorable Court to his original petition filed herein to demonstrate the following additional grounds for the granting of a writ of certiorari:

(a) The Ninth Circuit Court of Appeals had decided an important question of Federal law which has not been, but should be, settled by this Court and in a way probably in conflict with applicable decisions of this Court on similar problems arising under the same provisions of the Revenue Act.

(b) A final decision by this Court will settle much pending litigation and eliminate further litigation.

Your petitioner also wishes to point out to this Court that there is presently pending before the United States Board of Tax Appeals a proceeding entitled "*Douglas Fairbanks vs. Commissioner of Internal Revenue*", Docket No. 95287, involving the identically same question for the calendar year 1930 and involving additional income taxes, attributable to this question, in the sum of \$87,283.01. A final decision in this matter would, of course, be controlling in that litigation.

Taxation being based upon principles of equity, it seems manifestly unjust that the fact of Fairbanks' residence

within the jurisdiction of the Ninth Circuit Court of Appeals should subject him to a liability for tax and interest exceeding \$200,000 while a resident within the jurisdiction of the Circuit Court of Appeals for the First Circuit should be absolved of income taxes, on a set of facts exactly identical in their legal effect.

WHEREFORE petitioner respectfully submits,

(1) That this petition for rehearing of its petition for certiorari be granted; and

(2) That an order enter vacating the order of this Honorable Court dated October 10, 1938 denying the petition for certiorari herein.

Respectfully submitted,

ARTHUR F. DRISCOLL,

Counsel for Petitioner.

I, ARTHUR F. DRISCOLL, counsel for petitioner, certify that the foregoing motions for leave to file a petition for rehearing, for an order vacating the order of this Court dated October 10, 1938, denying the petition for certiorari herein, for an order staying the entry of judgment in the instant case in the United States District Court for the Southern District of California, Central Division, and this petition for Re-hearing are presented in good faith and not for the purpose of delay.

ARTHUR F. DRISCOLL

APPENDIX A.

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE FIRST CIRCUIT

OCTOBER TERM, 1938.

FRANCES M. AVERILL,

Petitioner for Review,

v.

COMMISSIONER OF INTERNAL REVENUE.

No. 3376.

PETITION FOR REVIEW OF A DECISION OF THE UNITED STATES
BOARD OF TAX APPEALS.

BEFORE BINGHAM, WILSON AND McLELLAN, JJ.

Opinion of the Court.

December 28, 1938.

McLELLAN, J. This petition to review a decision of the Board of Tax Appeals presents the question whether the gain realized by the petitioner when bonds owned by her were paid at maturity in 1931 should be taxed as ordinary income. The Board decided that such gain should be taxed as ordinary income; the petitioner urges that it should be taxed as capital gain at the maximum rate of 12½ per cent. The Board erred and the petitioner should prevail:

1. If a transaction in 1927 in which she parted with some stock and received cash and bonds was a sale for a price payable by installments and not as to her a statutory reorganization; or

2. If, though the 1927 transaction was not a sale, the 1931 surrender of her bonds then maturing for which she received payment was a "sale or exchange" within the meaning of the Revenue Act of 1928.

The reason the petitioner should prevail if she sold her stock in 1927 is that the rights of the parties would then be governed by a statute permitting the taxpayer who sells or otherwise disposes of property on the installment plan to return as income in any taxable year that portion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the total contract price (Revenue Act of 1926, Section 212(d)), and by a statute giving the taxpayer in case of a capital net gain an election to pay a $12\frac{1}{2}$ per cent tax thereon (Revenue Act of 1928, Section 101(a)). The reason the petitioner should prevail if the transaction by which she gave up her bonds and received payment therefor in 1931 constituted a sale or exchange of the bonds is that in such a case the statute last cited gives the taxpayer an option to pay a $12\frac{1}{2}$ per cent tax on a capital gain, which Section 101(c) of the Revenue Act of 1928 defines as "a taxable gain from the sale or exchange of capital assets."

We proceed to state the facts material to these two questions.

For more than two years prior to January 1, 1927, the petitioner had owned 1500 shares of the common stock of Keyes Fiber Company, hereafter sometimes called the old company. This corporation at all times here material had outstanding but one issue of stock—its common stock, of which there were 6000 shares.

On July 27, 1927, the petitioner, her husband George S. Averill and other shareholders representing in all 5912 shares, entered into a contract with the Rex Pulp Products Company, hereinafter called Rex. In this contract the shareholders of the old company, referred to therein as "the vendors," agreed to "sell, assign and convey all the shares owned by them to a new corporation to be organized under the laws of Maine, hereinafter known as the vendee, to be called Keyes Fiber Company, Inc., or some similar name, at the agreed purchase price of seven hundred fifty (750) dollars per share." Rex agreed "that it will cause the vendee to pay to each of said vendors on or before the 11th day of August, 1927, at the Fidelity Trust Company, Portland, Maine, for the num-

ber of shares of stock in said company which said vendors shall properly deliver to the order of the vendee at the Fidelity Trust Company, Portland, Maine, the sum of seven hundred fifty (750) dollars per share." Rex also agreed that "such payments shall be made as follows, viz: $\frac{5}{9}$ (five ninths) of the purchase price for said shares shall be paid in the first mortgage bonds of the vendee and the remaining $\frac{4}{9}$ (four ninths) of such price shall be paid in cash." It was further agreed that the proportion of bonds and cash paid to the individual vendors should be as agreed upon among themselves. The contract provided in substance that the first mortgage bonds should constitute a first lien on all the property "now or hereafter acquired" by either the old company, or Rex, or the corporation to be organized.

Later, Keyes Fiber Company, Inc., hereafter sometimes called the new company, was organized. On August 11, 1927, certain corporate votes were passed by the old Company, Rex, and the new company. The new company first acquired all the assets of Rex in exchange for its own common stock. It then assumed those obligations which the contract of July 27 provided that it should assume, and voted to purchase the 5912 shares of the old company as provided in the contract. The stock of the old company was then assigned to the new company, which immediately pledged it to a trustee as security for the performance of its obligations under the contract. The old company then conveyed all its assets to the new company for the agreed price of \$4,500,000, and this sum was paid to it by the new company, $\frac{4}{9}$ s in cash and $\frac{5}{9}$ ths in bonds. The old company then made a liquidating dividend to its stockholders of \$750 a share, $\frac{4}{9}$ ths in cash and $\frac{5}{9}$ ths in bonds, and was later dissolved. This dividend was received by the new company as holder of the stock of the old company, and was immediately transferred to the former stockholders of the old company in exchange for their stock, in accordance with the terms of the contract of July 27 and of the pledge to the trustee. While, as heretofore stated, the contract of July 27, 1927 provided that the purchase price of the stock should be paid $\frac{5}{9}$ ths in bonds of the vendee and

4/9s in cash, there was a provision that "the proportion of payment of bonds and cash should be such as is agreed upon among said vendors." Accordingly, the petitioner received \$275,000 cash, which was just less than 25 per cent of the purchase price, and \$850,000 in serial bonds which were of the par value of \$1,000 cash and worth par when received in 1927. One tenth of the petitioner's 850 bonds matured in each of the years 1931 to 1936 inclusive and four tenths in 1937.

At all material times up to August 11, 1927, the date on which the petitioner disposed of her stock in the old company, her husband, Dr. George G. Averill, was a large stockholder, a director, treasurer and clerk of the old company. The petitioner held no office in the old company. Neither Dr. nor Mrs. Averill held any office in Rex Pulp Products Company or the new company at any time, nor did either of them hold any office in the old company at any time after the petitioner disposed of her stock. Thus it appears that so far as the petitioner is concerned all she did was to transfer her stock in the old company for cash and serial bonds of the transferee.

As heretofore indicated, the first question is whether the transaction in 1927 was tantamount to a sale by the taxpayer of her corporate stock for a price to be paid in installments.

The Board decided and the Commissioner contends that it was not a sale but an exchange by a party to a reorganization of stock in a corporation for securities in another corporation in pursuance of the plan of reorganization. Some of the essentials of a statutory reorganization inhered in what was done in 1927. These we think it unnecessary to discuss in detail. That the corporate bonds may be deemed "securities" within the meaning of the reorganization provisions of the statute is settled by *Helvering v. Watts*, 296 U. S. 387, where the Supreme Court said: "The bonds, we think, were securities within the definition, and cannot be regarded as cash, as were the short term notes referred to in *Pinellas Ice and Cold Storage Company v. Commissioner*, 287 U. S. 462." The decision that the bonds there involved "were securities within the definition, and cannot be regarded as cash" is referable to

a contract where no sale but only an exchange for stock and bonds was intended. An inspection of the contract in that case, appearing in 28 B. T. A. 1056, shows that the parties contemplated no sale, but only an exchange of stock for stock and bonds. Consistent with the rest of the contract are the clauses reading:

"Whereas, said Parker Sloane is exchanging and delivering to and with the Vanadium Corporation of America Thirty Thousand (30,000) shares of the stock of the United States Ferro Alloys Corporation, * * * and

"Whereas, the Vanadium Corporation of America is exchanging and delivering to said Parker Sloane, Trustee for the owners of said United States Ferro Alloys Corporation" (certain shares of stock together with certain bonds).

We understand the Watts case as holding that bonds may be deemed securities, and that if treated as such, they cannot be regarded as cash. It does not indicate that where, as in the case at bar, a person expresses his intention to sell and another to buy corporate stock and both parties contemplate a sale for a price payable by installments, that the transaction loses its character as such just because the vendee's obligation is represented in part by serial bonds. Neither does the Watts case nor, so far as we know, any other decision of the Supreme Court of the United States, decide that the ownership of bonds without stock ever constitutes such a continuing interest as is essential to a statutory reorganization, a question which we are not called upon to decide. *Cf. Worcester Salt Company v. Commissioner*, 75 Fed. (2d) 251 (C. C. A. 2d) and *Lilienthal v. Commissioner*, 80 Fed. (2d) 411 (C. C. A. 9th).

The instant case discloses that the taxpayer contracted to sell her stock at \$750 a share and the new corporation undertook to buy it at that price. The total price was to be paid, as to about 25 per cent thereof, in cash and the balance over a

period of years. The petitioner's husband then relinquished his connections with the old company and had nothing to do with the management of the new one. Both intended to get out of the business and the new company intended that they should. The substance of the transaction was a sale by installments and the serial bonds were treated merely as a convenient method of providing for the installment payments. We see no adequate reason for saying that the intention of the parties should not be given effect. As to the taxpayer, the transaction amounted to a sale of her stock, not an exchange "by a party to a reorganization of stock in a corporation for securities in another corporation, a party to the reorganization, in pursuance of the plan of reorganization."

As before stated the taxpayer sold her stock in 1927 for a price payable in installments. Within the meaning of the statute she did not exchange it for securities in another corporation. The sale was casual, the purchase price exceeded \$1,000 and the initial payment received in cash other than evidences of indebtedness of the purchaser during the year in which the sale was made and did not exceed one-quarter of the purchase price. In short, the transaction was within Section 212 of the Revenue Act of 1926, which permits the return in any taxable year of "that proportion of the installment payments actually received in that year which the total profit realized or to be realized when the payment is completed bears to the whole contract price."

In her tax return for 1927 the petitioner reported gains from the disposition of her stock upon the installment basis and upon that basis her income tax for that year was paid. The Commissioner made no adjustment of the tax as to the petitioner, though he "disallowed the use of the installment basis as to Dr. George G. Averill and computed the gain under the reorganization exchange provisions." In the position then taken by the taxpayer she was right. Collection of the serial bonds falling due in 1931, with which we are here concerned, involved a net gain which, by virtue of Section 101 of the Revenue Act of 1928, is taxable at 12½ per cent.

We now come to a different question. If the 1927 transaction were governed by the statutory reorganization provisions, it would not follow necessarily that the Board's decision is correct. When in 1931 the taxpayer surrendered her bonds then maturing and received payment therefor, she realized a gain over their stipulated cost. Her right to treat this profit as a capital gain taxable at the rate of $12\frac{1}{2}$ per cent depends upon the portions of the Revenue Act of 1928 which follows:

SEC. 101. CAPITAL NET GAINS AND LOSSES.

(a) Tax in case of capital net gain.—In the case of any taxpayer, other than a corporation, who for any taxable year derives a capital net gain (as hereinafter defined in this section), there shall, at the election of the taxpayer, be levied, collected, and paid, in lieu of all other taxes imposed by this title, a tax determined as follows: a partial tax shall first be computed upon the basis of the ordinary net income at the rates and in the manner as if this section had not been enacted and the total tax shall be this amount plus $12\frac{1}{2}$ per centum of the capital net gain.

(c) Definitions.—For the purposes of this title—

(1) "Capital gain" means taxable gain from the sale or exchange of capital assets.

* * * * *

(7) "Ordinary net income" means the net income, computed in accordance with the provisions of this title, after excluding all items of capital gain, capital loss, and capital deductions.

(8) "Capital assets" means property held by the taxpayer for more than two years * * *

At the outset we are confronted with the question whether it is so clear that the words "taxable gain from the sale or exchange of capital assets" do not include a transaction whereby bonds are redeemed at maturity that we are not per-

mitted to use the canons of interpretation commonly used where the question is fairly debatable. If it were true that in the very nature of things a covenantee cannot sell a bond or other specialty to the covenantor, this would tend to support the Board's decision. But we think the holder can sell the bond to anybody. The incidents of such sales vary. If the bond is sold to a stranger, he gets it and with it the right to enforce it. If an attempted sale is made to the covenantor, he gets the bond though he acquires no right to enforce it. Perhaps one way to put it is that in either case there is a sale or transfer of title for a price—that in one case the subject matter of the sale is the bond as a valid obligation, and that in the other case the subject matter of the sale is the bond as something calculated no longer to represent contractual rights. It makes no difference whether the transaction is regarded as the sale of a contract right to a stranger or as a sale of a "piece of paper" to the covenantor. In either case the original holder may be regarded as having realized a gain from the sale of a specialty.

In prior decisions and in the case at bar the Board adheres to the view that preferred stock may be sold to the corporation which issued it. *Helvering v. Schoellkopf*, recently decided by the Second Circuit and not yet reported, indicates that within the meaning of the reorganization statute a corporation's own shares cannot be regarded as "property acquired" by it. But we find nothing there requiring the conclusion that a bond, particularly in a state where the distinction between sealed and unsealed instruments has not been abolished, cannot be sold to its maker.

Moreover, a transaction whereby a holder surrenders his bond and receives payment thereof or therefor has commonly been called a redemption, which derivatively and according to the dictionaries, and Judge Wilson's opinion while Chief Justice of the Maine Supreme Court, is a repurchase. *Bernstein v. Blumenthal*, 127 Me. 393, 396.—

We think the proper construction of the words "taxable gain from the sale or exchange of capital assets" sufficiently debatable to warrant a brief reference to the history of this clause of the statute.

The first legislation according special treatment to capital gains is in the Revenue Act of 1921. There the definition of capital gain as "taxable gain from the sale or exchange of capital assets" first appeared. It reappeared in the intervening Acts and that of 1932. Referring to the purpose of the Congress in passing the Revenue Act of 1921, the Supreme Court of the United States in *Burnet v. Harmel*, 287 U. S. 103, 106, said:

" * * * The provisions of the 1921 Revenue Act for taxing capital gains at a lower rate, re-enacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions."

Prior to the Revenue Act of 1928, here applicable, the practice had been to treat gains incident to the redemption of bonds as ordinary income. The tendency of the use of the same language in the 1928 Act was to indicate a congressional intent to the same effect. But after the 1928 Act was passed there was a series of events pointing another way.

In *Werner v. Commissioner*, 15 B. T. A. 482, the Board of Tax Appeals in 1929 recited the legislative history of the statutory definition now under consideration and concluded that the redemption of "called" bonds constituted a "sale or exchange." It may be stated parenthetically that no importance was attributed to the fact that the bonds were "called" and we do not see how that fact is of consequence. After this decision by the Board, the Commissioner in IT : 2488 (2 C. B. 127) revoked his previous ruling and directed that the net gains from bonds held for more than two years received as a result of the maturity of the bonds or as a result of their redemption before maturity may, at the option of the taxpayer, other than a corporation, be taxed under the capital gains section of the Revenue Act of 1921. This ruling was also made applicable to the Revenue Acts of 1924, 1926, and 1928. As stated in the petitioner's brief, "thus, from 1929

until December 1932, the ruling of the administrative department of the Government in charge of the collection of income taxes, as well as the ruling of the Board, interpreted the statute in accord with the petitioner's contention." In the light of this interpretation, Congress in 1932 reenacted its definition of "capital gain" in precisely the same language. Unless the Werner case was plainly erroneous, and we do not think it was, this reenactment of the statute might well be considered as a satisfactory interpretation of the legislative intent. *Buttolph v. Commissioner*, 29 Fed. (2d) 695 (C. C. A. 7th, 1928). See also *Hassett v. Welch*, 303 U. S. 303.

On December 29, 1932, the Board of Tax Appeals reversed the Werner decision (*Watson v. Commissioner*, 27 B. T. A. 463). Thereafter, as shown in a publication of the Government Printing Office entitled "Revenue Revision, 1934. Hearing before the Committee on Ways and Means, House of Representatives, 73d Congress, Second Session, December 15 to 21, 1933 and January 9 to 11, 1934," the American Bar Association recommended that the Congress re-define the terms "capital gain" and "capital loss" to make clear whether such terms include gains and losses resulting from the redemption at maturity of capital assets. In the Revenue Act of 1934 it was provided:

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) General Rule.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income: (there follows a statement as to the percentages).

In subdivision (f) of the same section it was provided that "for the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation * * * shall be considered as amounts received in exchange therefor."

There seem to us two admissible views as to the bearing of this legislation, one that it constitutes a legislative declaration of the meaning of the word "exchange" and governs the construction of the word in prior Acts, the other the view expressed by the Circuit Court of Appeals for the 9th Circuit in the following language:

"When Congress determined, as it did in 1934, to treat as 'capital gains' gains resulting from the retirement of bonds issued by a government or corporation, it had no difficulty in expressing its intent in clear and unambiguous language. Revenue Act of 1934, Sec. 117 (f), 48 Stat. 715, 26 U. S. C. A. Sec. 101 (f). If such intent had existed prior to 1934, it could and, we think, would have found similar expression."

United States v. Fairbanks, 95 Fed. (2d) 794, 796.

Though the question seems to us a close one, we think under all the circumstances that the doctrine enunciated by Chief Justice Marshall in *Alexander v. The Mayor of Alexandria*, 5 Cranch 1, is here relevant. He there said:

"Without deciding this question as depending merely on the original law, it is to be observed that acts *in pari materia* are to be construed together as forming one act. If in a subsequent clause of the same act provisions are introduced, which show the sense in which the legislature employed doubtful phrases previously used, that sense is to be adopted in construing those phrases. Consequently, if a subsequent act on the same subject affords complete demonstration of the legislative sense of its own language the rule which has been stated, requiring that the subsequent should be incorporated into the foregoing act, is a direction to courts in expounding the provisions of the law."

This language is quoted in full in this court's opinion in *Panther Rubber Co. v. Commissioner*, 45 Fed. (2d) 314, where Judge Wilson also said:

"Congress, by substitute provisions, *in pari materia* with section 250 of the Revenue Act of 1921, has indicated that such was its intent, and has made it clear in the act of 1924 and especially in the Revenue Act of 1928. In the Revenue Act of 1924, Sec. 278 (c), Congress provided that assessment and collection may be had after the expiration of the statutory period, where the taxpayer and commissioner, 'have consented,' indicating a past act. This might not be conclusive, but Congress in the Revenue Act of 1928 clearly indicated its intent (see chapter 852, Sec. 276 (26 U. S. C. A. Sec. 2276)), and required the waiver to be signed before the limitation period for assessing the tax expired."

See also:

Old Colony Trust Company v. Malley, 19 Fed. (2d) 346.

We think the taxpayer's 1931 gain not taxable as ordinary income, but as capital gain at the maximum rate of 12½ per cent because the 1927 transaction was a sale for a price payable in installments not affected by the reorganization provisions of the statute, and because, if this is not so, the redemption of her bonds in 1931 resulted in a "capital gain" within the meaning of the statutory definition of that term.

The decision or order of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.

APPENDIX B.

IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

UNITED STATES OF AMERICA.		No. 8444 Apr. 2, 1938
	Appellant.	
vs.		
DOUGLAS FAIRBANKS,		
	Appellee.	
<hr/>		
DOUGLAS FAIRBANKS,		No. 8444 Apr. 2, 1938
	Appellant,	
vs.		
UNITED STATES OF AMERICA.		
	Appellee.	
<hr/>		

Upon Appeals from the District Court of the United States
for the Southern District of California, Central Division.

Before GARRECHT, MATHEWS and HANEY, *Circuit Judges*.

MATHEWS, *Circuit Judge*:

The United States (hereafter called plaintiff) brought this action against Douglas Fairbanks (hereafter called defendant) to recover amounts aggregating \$72,186.54 claimed to have been erroneously refunded to defendant on account of alleged overpayments of income taxes for 1927, 1928 and

1929, with 6% interest from the date of refund, January 26, 1932. The case was tried by the court without a jury, trial by jury having been expressly waived. The court made and filed special findings of fact and thereupon entered judgment in favor of plaintiff for the principal sum claimed, with 7% interest from the date (July 6, 1933) on which payment had been demanded of defendant. Both parties have appealed, plaintiff claiming that interest should have been allowed from the date of refund, defendant claiming that judgment should have been entered in his favor.

The action was brought under §610(b) of the Revenue Act of 1928, 45 Stat. 875, 26 U. S. C. A., §1646(b), which provides: "Any portion of an internal revenue tax (or any interest, penalty, additional amount, or addition to such tax) which has been erroneously refunded * * * may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund."

Section 1104 of the Revenue Act of 1932, 47 Stat. 287, 26 U. S. C. A., §1670(a)(3), provides: "Where the Commissioner has (before or after June 6, 1932) signed a schedule of overassessments in respect of any internal revenue tax imposed by the Revenue Act of 1932, or any prior revenue Act, the date on which he first signed such schedule (if after May 28, 1928) shall be considered as the date of allowance of refund or credit in respect of such tax."

In this case, the schedule of overassessment was signed by the Commissioner on January 6, 1932. The refund check was delivered to the taxpayer on January 26, 1932. This suit was begun on January 20, 1934, more than two years after the signing of the schedule, but less than two years after the delivery of the refund check. Defendant contends that the two-year period specified in §610(b) begins to run upon allowance of the refund—that is to say, upon the signing of the schedule by the Commissioner—and that this action, therefore, was not commenced in time. There is no merit in this contention. The two-year period commences, not upon the allowance, but upon the actual making of the refund.

United States v. Wurts, U. S., decided March 14 1938.¹ This action was in time.

The trial court's findings of fact are not challenged. Facts found were as follows:

Defendant in 1925 became the owner and registered holder of debenture bonds of the Elton Corporation of the par value of \$4,000,000, dated March 5, 1925, payable March 5, 1935. Each bond contained the following provision: "This debenture bond may be redeemed by the corporation at any time at its face value plus interest earned and unpaid hereon upon thirty days' notice to the registered holder thereof." In 1927, 1928 and 1929, the corporation did so redeem bonds held by defendant, of the aggregate par value of \$1,900,000, and defendant realized therefrom a taxable gain.

The question now to be decided is whether the gain so realized by defendant was a "capital gain," within the meaning of §208(a)(1) of the Revenue Act of 1926, 44 Stat. 49, and §101(c)(1) of the Revenue Act of 1928, 45 Stat. 811. If so, it was taxable at the rate of 12½%.² If not, it was taxable at the higher (normal and surtax) rates³ applicable to other income of defendant for the taxable years in question.

By §§208(a)(1) and 101(c)(1) the term "capital gain" is defined as meaning "taxable gain from the sale or exchange of capital assets consummated after December 31, 1921." It is conceded that the bonds in question were capital assets, and that they were redeemed after December 31, 1921. The question is whether such redemption constituted a "sale or exchange" of the bonds, within the meaning of §§208(a)(1) and 101(c)(1).

We think not. Between the *redemption* of a bond and the *sale or exchange* thereof, there is a clear distinction. Such redemption is merely the payment of an obligation according

¹ Reversing United States v. Wurts (C. C. A. 3), 91 F. (2d) 547, cited by defendant.

² Revenue Act of 1926, §208(c), 44 Stat. 20; Revenue Act of 1928, §101(b), 45 Stat. 811.

³ Revenue Act of 1926, §§210(a), 211(a), 44 Stat. 21; Revenue Act of 1928, §§11, 12(a), 45 Stat. 795, 796.

its terms. It is in no wise a sale or exchange. *Watson v. Commissioner*, 27 B. T. A. 463, 465;⁴ *Braun v. Commissioner*, B. T. A. 1161, 1177.

First of the revenue acts accordng special treatment to capital gains was that of 1921. The above quoted definition "capital gain" is found in the 1921 and subsequent revenue acts to and including that of 1932. 42 Stat. 232, 43 Stat. 2, 44 Stat. 19, 45 Stat. 811, 47 Stat. 191. Defendant cites report No. 350 of the House Ways and Means Committee and report No. 275 of the Senate Finance Committee, accompanying the Revenue Bill of 1921, as indicating a purpose to include in this definition gains resulting from the redemption of capital assets. We find in these reports no indication of any such purpose. In *Burnet v. Harmel*, 287 U. S. 103, 36, cited by defendant, the court said:

"Before the Act of 1921, gains realized from the sale of property were taxed at the same rates as other income, with the result that capital gains, often accruing over long periods of time, were taxed in the year of realization at the high rates resulting from their inclusion in the higher surtax brackets. The provisions of the 1921 revenue act for taxing capital gains at a lower rate, reenacted in 1924 without material change, were adopted to relieve the taxpayer from these excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions. House Report No. 350, Ways and Means Committee, 67th Cong., 1st Sess., on the Revenue Bill of 1921, p. 10; see *Alexander v. King*, 46 F. (2d) 235."

Thus, it appears, the purpose of Congress in relieving the taxpayer from "excessive tax burdens from gains resulting from a conversion of capital investments" was "to remove the deterrent effect of those burdens on such conversions." Conversions on which those burdens had a deterrent effect were sales and exchanges. Such burdens had, and have, no

⁴Overruling *Werner v. Commissioner*, 15 B. T. A. 482, cited by defendant.

deterrent effect on the redemption of bonds or other capital assets. This, doubtless, is the reason why, prior to 1934, gains resulting from such redemption were never included in the definition of "capital gain." Whatever the reason, such gains were not so included, and the definition should not, we think, be expanded by judicial construction.

When Congress determined, as it did in 1934, to treat "capital gains" gains resulting from the retirement of bonds issued by a government or corporation, it had no difficulty expressing its intent in clear and unambiguous language. Revenue Act of 1934, §117(f), 48 Stat. 715. If such intent had existed prior to 1934, it could and, we think, would have found similar expression.

In awarding judgment for the principal sum claimed, the trial court did not err. It erred to the prejudice of plaintiff in allowing interest from the date of demand only. It erred to the prejudice of defendant in allowing interest at 7%. Section 610(d) of the Revenue Act of 1928, as amended by §805(a) of the Revenue Act of 1936, 49 Stat. 1744, provides: "Erroneous refunds recoverable by suit under this section shall bear interest at the rate of 6 per centum per annum from the date of the payment of the refund." In this case, therefore, 6% interest should have been allowed from January 26, 1932.

As to the principal sum awarded (\$72,186.94), the judgment is affirmed. As to interest, it is reversed and the case is remanded, with directions to enter judgment in plaintiff's favor for 6% interest on said principal sum from January 26, 1932.

(Endorsed:) Opinion. Filed Apr. 2, 1938. Paul O'Brien, Clerk.

SUPREME COURT OF THE UNITED STATES.

No. 65.—OCTOBER TERM, 1938.

Douglas Fairbanks, Petitioner,
vs.
The United States of America.

On Writ of Certiorari to
the United States Circuit
Court of Appeals for the
Ninth Circuit.

[March 27, 1939.]

Mr. Justice McREYNOLDS delivered the opinion of the Court.

Both courts below ruled that gain derived by the petitioner from redemption of bonds during 1927, 1928 and 1929 was not "capital gain" within the meaning of the controlling statutes.

No contest now exists concerning the facts. The narrow point a counsel agree is this—Must the redemption of bonds before maturity by the issuing corporation be treated as tantamount to a sale or exchange of capital assets within the meaning of section 38(a) (1), Revenue Act 1926, and section 61(c) (1), Revenue Act 1928.¹

If redemption amounts to sale or exchange, the petitioner's gain was subject to taxation at the twelve and one-half per cent rate; otherwise, under normal and surtax rates.

Payment and discharge of a bond is neither sale nor exchange within the commonly accepted meaning of the words. The courts below found no sufficient reason for disregarding this and rightly applied the statutes under that view.

The Tax Acts of 1921, 1924, 1926, 1928 and 1932 contain like definitions of capital gain. From 1921 to 1929 the Commissioner held that such gain did not arise from redemption. In 1929 the Board of Tax Appeals held otherwise. *Werner v. Commissioner*, 15

¹ Revenue Act 1921 (November 23, 1921, c. 136, 42 Stat. 227, 232) provides—

"Sec. 206. (a) That for the purpose of this title:

(1) The term 'capital gain' means taxable gain from the sale or exchange of capital assets consummated after December 31, 1921."

This provision without material change was reenacted by Revenue Act 1924 (June 2, 1924, c. 234, sec. 206(a) (1), 43 Stat. 253, 262); Revenue Act 1926 (February 26, 1926, c. 27, sec. 206(a) (1), 44 Stat. 9, 19); Revenue Act 1928 (May 29, 1928, c. 852, sec. 101(c) (1), 45 Stat. 791, 811); Revenue Act of 1932 (June 6, 1932, c. 209, sec. 101(c) (1), 47 Stat. 169, 191).

B. T. A. 462. But in 1932 it definitely overruled that determination. *Watson v. Commissioner*, 27 B. T. A. 463.

The Revenue Act 1934 (May 10, 1934, c. 277, 48 Stat. 680, 714-715) provides—

“SEC. 117. CAPITAL GAINS AND LOSSES.

(a) General Rule.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

(f) Retirement of Bonds, Etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.”

What we regard as the correct meaning of the definition of capital gain in the Revenue Act 1921 and its four successors is accentuated by long-continued executive construction, also the last conclusion of the Board of Tax Appeals.

The Circuit Court of Appeals below was right in holding that by the Act 1934 Congress did not attempt to construe the prior Acts and purposely made a material addition thereto. In *Averill v. Commissioner of Internal Revenue* (decided Dec. 28, 1938), the Circuit Court of Appeals First Circuit acted upon a different view. This conflict caused us to bring up the present cause notwithstanding the application for certiorari had been denied earlier in the term.

The challenged judgment must be

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

